The Big Picture: Trends in Defined Contribution Plans

By Randy Myers

From the left: Elizabeth Heffernan, Fidelity Employer Services Company; Sara Richman, Great-West; Philip Maffei, TIAA-CREF

Investors in 401(k) plans may not be saving enough for retirement, on average, but they're saving more than headline numbers would suggest.

In a wide-ranging panel discussion at the 2013 SVIA Fall Forum, Elizabeth Heffernan, vice president of investment product management at Fidelity Investments, said the average account balance in plans for which Fidelity provides recordkeeping services is about $80,000. But that figure has been depressed, she observed, by the trend among plan sponsors to adopt automatic enrollment policies. Automatic enrollment brings into their plans new participants with very low account balances.

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portfolio manager in the Stable Value Markets Group for Prudential Retirement. "And it's tough competition. We're looking at competing against paying the bills, buying a new car, the apartment with a balcony. There's also a significant amount of participant inertia to overcome."

To address the issues, King said the retirement industry must continue to embrace the use of automatic features in defined contribution plans, including automatic enrollment of workers, automatic escalation of participant contributions, and automatic rebalancing of their portfolios so as to maintain an appropriate asset allocation mix over time.

"We need to address the needs of our Millennials, who actually outnumber Baby Boomers and think very differently," King said. Millennials, the generation born between roughly 1985 and 2000, are hyper-connected, fully-integrated, and socially-networked. A recent survey sponsored by Merrill Lynch concluded that Millennials take nothing at face value and want to remain in the driver's seat when it comes to investments, among other things. "So hopefully SVIA's recent forays into social media, specifically LinkedIn and Twitter, will help to educate this important cohort about the benefits of stable value," King said. "The industry must continue to educate and inform fiduciaries and policy makers, too, to ensure that they understand the asset class."

The industry also needs to get involved with target date funds, King said. "Stable value can be an allocation in customized target-date funds," he argued. "It is important for the asset class to grow with those funds. We have the ability to compete in that space." According to Morningstar, target date funds grew from about $157 billion in 2008 to $508 billion in the first quarter of 2013, and retirement industry consensus suggests this is a trend that will likely continue.

King encouraged stable value providers to continue working to increase penetration in defined contribution plans that don't currently offer stable value, as well as in 529 tuition assistance plans. Current market conditions should help in that effort, he added, noting that stable value funds have a significant return advantage over money market funds, which have been yielding nearly zero percent for about four years, and have a regulatory horizon that can be described as "stormy at best."

"We can also try to crack the code for the Individual Retirement Account (IRA) market," he said. "If we can do that, we can more than double our opportunity set." Under the current regulatory regime, stable value funds cannot be offered to IRA investors.

In summary, King said stable value as an asset class is in great shape. "We have a significant share of the marketplace," he said. "We have new wrap capacity in the market. We have new entrants providing contracts that meet the new conditions of the marketplace. We have several existing providers continuing to grow their business. We also have some wrap providers who are holding pat and not exiting the market. We also have demographics in our favor; Boomers are retiring at a rate of 10,000 a day, and data from the Investment Company Institute and the Employee Benefit Research Institute show the 60-year and up age cohort saving up to 30 percent of their assets in stable value. So we have some excellent tailwinds.

"We've also gone from the defensive to the offensive in the press," he concluded. "Through the financial crisis, and until very recently, we were reacting to negative press in the marketplace. Now, we are posting positive articles on our website from publications like *Barron's, The Wall Street Journal, Pensions & Investments,* and *Forbes*. The asset class is in a good place." SVIA

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When Fidelity looks only at actively employed participants who have been enrolled and contributing to their plans for at least 10 years, Heffernan said, the average account balance is much higher: $211,000. “If you keep people in (the plans),” she observed, “the numbers do get much better.”

Heffernan was part of a panel discussion that examined trends in each of the three main segments of the defined contribution plan marketplace: 401(k) plans, which are sponsored by private employers; 457 plans, offered primarily by government employers; and 403(b) plans, which are sponsored by public education organizations and some non-profit employers. Among the highlights:

The 401(k) market

In the 401(k) market, Heffernan said, automatic enrollment is increasingly becoming the norm, especially among larger plans. Only about 24 percent of the plans on its books use it, she said, but those plans cover 55 percent of plan participants.

Other key trends Heffernan cited:

- Target-date funds are the most common default investment option in plans for which Fidelity provides record-keeping services. Also, just over half of the Millennials in those plans, who represent about a third of the overall participant base, contribute 100 percent of their money to target-date funds.
- Stable value funds are widely used by Fidelity clients, particularly in the larger corporate plan market, although they also enjoy a “fair amount of exposure” in the private employer market. However, Heffernan said, among new plans coming onto Fidelity’s platform, only a small percentage is choosing to offer a stable value investment option. “That’s a bit of a concern,” she said, “although certainly plan sponsors are still committed to it (stable value) in the private employer market.”

The 457 market

Sara Richman, vice president of product management at Great-West Financial, said one of the characteristics of the 457 marketplace is that they tend to be paternalistic. The 457 market includes state and local government plans and also plans sponsored by quasi-governmental employers such as water systems, public schools and public hospitals.

Still, participation rates in 457 plans are lower than they are for 401(k) plans. About 26 percent of eligible employees participate in 457 plans, Richman said, versus about 89 percent in the 401(k) market. Richman attributed the difference in part to the fact that many employees in the 457 market have access to a defined benefit plan at work, and so they view the 457 as a supplemental savings vehicle. Also, automatic enrollment is a fairly rare feature in 457 plans, with only about 8 percent of participants covered.

Although 457 plans are not subject to ERISA—the Employee Retirement Income Security Act—457 plan sponsors often look to ERISA as a guide, Richman noted. Investment options tend to look much like those available in 401(k) plans, with most plans including a stable value fund in their lineup. Target-date funds are also popular, and are often customized for larger plans.

While most 401(k) plans have a designated default investment option, Richman said about 30 percent of 457 plans have none. Among those that do, about 50 percent use target-date funds, and about 10 percent use stable value.

Like their corporate counterparts, sponsors of 457 plans are concerned about the ongoing funding burden associated with their defined benefit plans, Richman said. Despite this, thus far sponsors have made few changes on that front, in part because they often must be negotiated with unions. Sponsors are also increasingly focused on the fees associated with the investment options they offer and are becoming more resistant to “proprietary” products offered by their plan provider, including rollover IRAs, funds and other services. She said multi-manager funds are in demand among large plans. This is also true within the stable value sector.

The 403(b) market

Philip Maffei, senior director in charge of the Stable Value Solutions team at TIAA-CREF, observed that 403(b) plans are offered by over 85 percent of not-for-profit employers in all industry sectors except healthcare, where the figure is

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Attendees at the Stable Value Investment Association Fall Forum 2013

Shields Says Income Inequality Could Be "Sleeper Issue" of 2016 Election

By Randy Myers

There are plenty of issues that could define the 2016 presidential election. Republicans and Democrats could still be fighting about taxes and spending, foreign policy, and even healthcare. But nationally known columnist and political commentator Mark Shields says that income equality could be the issue that determines who will occupy the White House next.

According to a recent white paper by the Economic Policy Institute, the average CEO now earns 273 times more than the average worker, up from 20 times in 1965. Meanwhile, a recent analysis of IRS data by economists Emmanuel Saez and Thomas Piketty found that the bottom 90 percent of American taxpayers earned only $59 more in 2011 than they did in 1966, adjusted for inflation. By contrast, incomes for the top 10 percent of taxpayers grew by $116,071.

"I believe there is a festering sense among voters that the economic system is rigged, and that nobody is really standing up for them," Shields told participants at the 2013 SVIA Fall Forum in Washington, D.C. "I think income equality could be the sleeper issue in 2016, just as Iraq was the issue in 2008 that defined and determined the Democratic nominee for president."

Shields did not predict which political party would benefit from this sentiment, observing that while Republicans are in worse shape than Democrats, neither party is popular right now. In fact, he said, a recent NBC/Wall Street Journal poll found Republicans at their lowest point in the history of the poll in terms of public favorability, with 51 percent of voters blaming them for the recent federal government shutdown, and only 31 percent blaming the Democrats and President Obama.

Still, Shields said, "This is not a time for Democrats to pop the champagne bottles; they are far from out of the woods. The Democrats are, and historically have been, the party of government; they believe it can be an engine of economic progress and social justice. But we are witnessing an erosion of public trust in government, which does not help the Democrats. Even if the Democrats win back a majority in the House, I do not have the sense that people are ready to march under any banner of enlarged public action."

One thing that is helping the Democrats, Shields noted, is a shift in the nation's demographics. When George H.W. Bush won the presidency in 1988, he said, the country was 89 percent white. Now it is 71 percent white. Republicans have generally been losing the battle for the hearts and minds of non-whites, in part because of the GOP's opposition to immigration reform. Republicans won only a quarter of the Latino vote in the 2012 presidential election, Shields noted, "and prospects going forward are even more dire."

While Americans have always been an optimistic people, Shields said that's no longer uniformly the case. For the first time, he said, a majority of Americans believe their children's lives will not be as bright as theirs have been, and that China, not the U.S., will lead the next century.

To reverse sentiment like that, and to improve cooperation in Washington, Shields said the country will need to find a presidential candidate "with a program that is straightforward and understandable, so that people can say, 'Yes, I believe that's in the best interests of the country,' and at the same time can rekindle that optimism." SVIA

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66 percent. Historically, 403(b) plans have used multiple record-keeping and investment vendors, although regulatory changes in 2009 and 2012 have resulted in many plans reducing the number of vendors they use, with some moving to a single record-keeper.

About 67 percent of not-for-profit employees who have access to a defined contribution plan—usually a 403(b)—participate in their plan, and on average contribute 8.1 percent of their salary, Maffei said.

Most 403(b) plans are limited by federal regulation to using mutual funds or annuity contracts; collective funds typically cannot be used. Other than public K-12 school systems, Maffei noted, a stable value option is available in about three-quarters of all plans. In the public K-12 market, that number is only 47 percent.

Since the Department of Labor issued rules spelling out what counts as a qualified default investment option (QDIA), the percentage of TIAA-CREF participants contributing to multi-asset class investments such as target-date funds has increased, to 34 percent in 2011 from 15 percent in 2005, Maffei said. During that same period, the percentage contributing to a principal preservation option decreased to 47 percent from 63 percent.

Like their 457 counterparts, 403(b) plans have been slow to embrace automatic enrollment. Only 14.6 percent use it, Maffei said, even though participation rates are significantly higher—by anywhere from six to 22 percentage points—among those that do. Automatic escalation of deferrals is used by only about a third of those plans that use automatic enrollment.

Even with these innovations only 44 percent of 403(b) plan participants say they are confident of being financially ready for retirement, he said, mirroring findings in other parts of the defined contribution plan marketplace. To improve outcomes, Maffei said more plan sponsors need to improve their plan design to incorporate features such as automatic enrollment and automatic deferral escalation; switch to a single plan-management platform to reduce complexity and minimize expenses; provide participants with access to low-cost fixed and variable annuities, mutual funds, and lifetime income solutions; provide objective, outcomes-based advice and education; and offer supplemental benefits such as retiree healthcare savings plans. SVIA