AMERICAN BENEFITS COUNCIL

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# DEFINED CONTRIBUTION PLANS: A SUCCESSFUL CORNERSTONE OF OUR NATION'S RETIREMENT SYSTEM

**Introduction**

Employer-sponsored 401(k) and other defined contribution retirement plans are a core element of our nation's retirement system, playing a critical role along with Social Security, personal savings and employer-sponsored defined benefit plans. Defined contribution plans successfully assist tens of millions of American families in accumulating retirement savings. Congress has adopted rules for defined contribution plans that:

- facilitate employer sponsorship of plans,
- encourage employee participation,
- promote prudent investing by plan participants,
- allow operation of plans at reasonable cost, and
- safeguard plan assets and participant interests through strict fiduciary obligations and intensive regulatory oversight.

While individuals have understandable retirement income concerns resulting from the recent market and economic downturns -- concerns fully shared by the American Benefits Council -- it is critical to acknowledge the vital role defined contribution plans play in building personal financial security.

**Defined Contribution Plans Reach Tens of Millions of Workers and Provide an Important Source of Retirement Savings**

Over the past three decades, 401(k) and other defined contribution plans have increased dramatically in number, asset value, and employee participation. As of June 30, 2008, defined contribution plans (including 401(k), 403(b) and 457 plans) held $4.3 trillion in assets, and assets in individual retirement accounts (a significant share of which is attributable to amounts rolled over from employer-sponsored retirement plans, including defined contribution plans) stood at $4.5 trillion.[1] Of course, assets have declined significantly since then due to the downturn in the financial markets. Assets in 401(k) plans are projected to have declined from $2.9 trillion on June 30, 2008 to $2.4

trillion on December 31, 2008,[2] and the average 401(k) account balance is down 27% in 2008 relative to 2007.[3] Nonetheless, 401(k) account balances are up 140% when compared to levels as of January 1, 2000.[4] Thus, even in the face of the recent downturn (which of course has also affected workers' non-retirement investments and home values), employees have seen a net increase in workplace retirement savings. This has been facilitated by our robust and expanding defined contribution plan system. As discussed more fully below, employees have also remained committed to this system despite the current market conditions, with the vast majority continuing to contribute to their plans.

In terms of the growth in plans and participating employees, the most recent statistics reveal that there are more than 630,000 defined contribution plans covering more than 75 million active and retired workers with more than 55 million current workers now participating in these plans.[5] Together with Social Security, defined contribution plan accumulations can enable retirees to replace a significant percentage of pre-retirement income (and many workers, of course, will also have income from defined benefit plans).[6]

**Employers Make Significant Contributions Into Defined Contribution Plans**

When discussing defined contribution plans, the focus is often solely on employee deferrals into 401(k) plans. However, contributions consist of more than employee deferrals. Employers make matching, non-elective, and profit-sharing contributions to defined contribution plans to complement employee deferrals and share with employees the responsibility for funding retirement. Indeed, a recent survey of 401(k) plan sponsors with more than 1,000 employees found that 98% make some form of employer contribution.[7] Another recent study of employers of all sizes indicated that 62% of defined contribution sponsors made matching contributions, 28% made both matching and profit-sharing contributions, and 5% made profit-sharing contributions only.[8] While certain employers have reduced or suspended matching contributions as a result of current economic conditions, the vast majority have not.[9] Those that have are often doing so as a direct result of substantially increased required contributions to their defined benefit plans or institution of a series of cost-cutting measures to preserve jobs. As intended, matching contributions play a strong role in encouraging employee participation in defined contribution plans.[10]

**The Defined Contribution System is More Than 401(k) Plans**

The defined contribution system also includes many individuals beyond those who participate in the 401(k) and other defined contribution plans offered by private-sector employers. More than 7 million employees of tax-exempt and educational institutions participate in 403(b) arrangements,[11] which held more than $700 billion in assets as of earlier this year.[12] Millions of employees of state and local governments participate in 457 plans, which held more than $160 billion in assets as of earlier this year.[13] Finally, 3.9 million individuals participate in the federal government's defined contribution plan (the Thrift Savings Plan), which held $226 billion in assets as of June 30, 2008.[14]

**401(k) Plans Have Evolved in Ways That Benefit Workers**
Even when focusing on 401(k) plans, it is important to keep in mind that these plans have evolved significantly from the bare-bones employee savings plans that came into being in the early 1980s. As discussed more fully below, employers have enhanced these arrangements in numerous ways, aiding their evolution into robust retirement plans. Congress has likewise enacted numerous enhancements to 401(k) plans, making major improvements to the 401(k) system in the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Pension Protection Act of 2006. Among the many positive results have been incentives for plan creation, promotion of automatic enrollment, catch-up contributions for workers 50 and older, safe harbor 401(k) designs, accelerated vesting schedules, greater benefit portability, tax credits for retirement savings, and enhanced rights to diversify company stock contributions.

There also has been tremendous innovation in the 401(k) marketplace, with employer plan sponsors and plan service providers independently developing and adopting many features that have assisted employees. For example, both automatic enrollment and automatic contribution escalation were first developed in the private sector. Intense competition among service providers has helped spur this innovation and has driven down costs. Among the market innovations that have greatly enhanced defined contribution plans for participants are:

- on-line and telephonic access to participant accounts and plan services,
- extensive financial planning, investment education and investment advice offerings,
- single-fund investment solutions such as retirement target date funds and risk-based lifestyle funds, and
- in-plan annuity options and guaranteed withdrawal features that allow workers to replicate attributes of defined benefit plans.

These legislative changes and market innovations have resulted in more employers wanting to sponsor 401(k) plans and have -- together with employer enhancements to plan design -- improved both employee participation rates and employee outcomes.

**Long-Term Retirement Plans Should Not Be Judged on Short-Term Market Conditions**
Workers and retirees are naturally concerned about the impact of the recent market turmoil. It is important, however, for policymakers and participants to evaluate defined contribution plans based on whether they serve workers' retirement interests over the long term rather than over a period of months. Defined contribution plans and the investments they offer employees are designed to weather changes in economic conditions -- even conditions as anxiety-provoking as the ones we are experiencing today. (Market declines and volatility are, of course, affecting all types of retirement plans and investment vehicles, not just defined contribution plans.) Although it is

difficult to predict short-run market returns, over the long run stock market returns are linked to the growth of the economy and this upward trend will aid 401(k) investors. Indeed, one of the benefits for employees of participating in a defined contribution plan through regular payroll deduction is that those who select equity vehicles purchase these investments at varying prices as markets rise and fall, achieving effective dollar cost averaging. If historical trends continue, defined contribution plan participants who remain in the system can expect their plan account balances to rebound and grow significantly over time.[15] That being said, the American Benefits Council favors development of policy ideas (and market innovations) to help those defined contribution plan participants nearing retirement improve their retirement security and generate adequate retirement income.

It is important to note that in the face of the current economic crisis and market decline, plan participants remain committed to retirement savings and few are reducing their contributions. Rather, the large majority of participants continue to contribute at significant rates and remain in appropriately diversified investments. One leading 401(k) provider saw only 2% of participants decrease contribution levels in October 2008 (1% actually increased contributions) despite the stock market decline and volatility experienced during that month.[16] Another leading provider found that 96% of 401(k) participants who contributed to plans in the third quarter of 2008 continued to contribute in the fourth quarter.[17] Research from the prior bear market confirms that employees tend to hold steady in the face of declining stock prices, remaining appropriately focused on their long-term retirement savings and investment goals.[18]

Demonstrating the importance of defined contribution plans to employees, a recent survey found that defined contribution plans are the second-most important benefit to employees behind health insurance.[19] The same survey found that 9% of employees viewed greater deferrals to their defined contribution plan as one of their top priorities for 2009.[20]

**Defined Contribution Plan Coverage and Participation Rates Are Increasing**
Participation in employer-sponsored defined contribution plans has grown from 11.5 million in 1975 to more than 75 million in 2005.[21] This substantial increase is a result of many more employers making defined contribution plans available to their workforces. Today, the vast majority of large employers offer a defined contribution plan,[22] and the number of small employers offering such plans to their employees has been increasing modestly as well.[23] In total, 65% of full-time employees in private industry had access to a defined contribution plan at work in 2008 (of which 78% participated).[24] Small businesses that do not offer a 401(k) or profit-sharing plan are increasingly offering workers a SIMPLE IRA, which provides both a saving opportunity and employer contributions.[25] Indeed, as of 2007, 2.2 million workers at eligible small businesses participated in a SIMPLE IRA.[26]

The rate of employee participation in defined contribution plans offered by employers also has increased modestly over time[27] -- with further increases anticipated as a result of automatic enrollment adoption. Moreover, participating employees are generally saving at significant levels -- levels that have risen over time.[28] Younger workers, in particular, increasingly look to defined contribution plans as a primary source of retirement income.[29]

There are understandable economic impediments that keep some small employers, particularly the smallest firms, from offering plans. The uncertainty of revenues is the leading reason given by small businesses for not offering a plan, while cost, administrative challenges, and lack of employee demand are other impediments cited by small business.[30] Indeed, research reveals that employees at small companies place less priority on retirement benefits relative to salary than their counterparts at large companies.[31] As firms expand and grow, the likelihood that they will offer a retirement plan increases.[32] Congress can and should consider additional incentives and reforms to assist small businesses in offering retirement plans, but some small firms will simply not have the economic stability to do so. Mandates on small business to offer or contribute to plans will only serve to exacerbate the economic challenges they face, reducing the odds of success for the enterprise, hampering job creation and reducing wages.

Some have understandably focused on the number of Americans who do not currently have access to an employer-sponsored defined contribution plan. Certainly expanding plan coverage to more Americans is a universally shared goal. Yet statistics about retirement plan coverage rates must be viewed in the appropriate context. Statistics about the percentage of workers with access to an employer retirement plan provide only a snapshot of coverage at any one moment in time. Given job mobility and the fact that growing employers sometimes initiate plan sponsorship during an employee's tenure, a significantly higher percentage of workers have access to a plan for a substantial portion of their careers.[33] This coverage provides individuals with the opportunity to add defined contribution plan savings to other sources of retirement income. It is likewise important to note that individuals' savings behavior tends to evolve over the course of a working life. Younger workers typically earn less and therefore save less. What younger workers do save is often directed to non-retirement goals such as their own continuing education, the education of their children or the purchase of a home.[34] As they age and earn more, employees prioritize retirement savings and are increasingly likely to work for employers offering retirement plans.[35]

**Defined Contribution Plan Rules Promote Benefit Fairness**

The rules that Congress has established to govern the defined contribution plan system ensure that retirement benefits in these plans are delivered across all income groups. Indeed, the Internal Revenue Code contains a variety of rules to promote fairness regarding which employees are covered by a defined contribution plan and the contributions made to these plans. These requirements include coverage rules to ensure that a fair cross-section of employees (including sufficient numbers of non-highly compensated workers) are covered by the defined contribution plan and nondiscrimination rules to make certain that both voluntary employee contributions and employer contributions for non-highly compensated employees are being made at a rate that is not dissimilar to the rate for highly compensated workers.[36] There are also top-heavy rules that require minimum contributions to non-highly compensated employees' accounts when the plan delivers significant benefits to top employees.

Congress has also imposed various vesting requirements with respect to contributions made to defined contribution plans. These requirements specify the timetable by which employer contributions become the property of employees. Employees are always 100% vested in their own contributions, and employer contributions made to employee accounts must vest according to a specified schedule (either all at once after three years of service or in 20% increments between the second and sixth years of service).[37] In addition, the two 401(k) safe harbor designs that Congress has adopted -- the original safe harbor enacted in 1996 and the automatic enrollment safe harbor enacted in 2006 -- require vesting of employer contributions on an even more accelerated schedule.[38]

**Employer Sponsorship of Defined Contribution Plans Offers Advantages to Employees**

As plan sponsors, employers must adhere to strict fiduciary obligations established by Congress to protect the interests of plan participants. ERISA imposes, among other things, duties of prudence and loyalty upon plan fiduciaries. ERISA also requires that plan fiduciaries discharge their duties "solely in the interest of the participants and beneficiaries" and for the "exclusive purpose" of providing participants and beneficiaries with benefits.[39] These exceedingly demanding fiduciary obligations (which are enforced through both civil and criminal penalties) offer investor protections not typically associated with savings vehicles individuals might use outside the workplace.

One area in which employers exercise oversight is through selection and monitoring of the investment options made available in the plan. Through use of their often considerable bargaining power, employers select high-quality, reasonably-priced investment options and monitor these options on an ongoing basis to ensure they remain high-quality and reasonably-priced. Large plans also benefit from economies of scale that help to reduce costs. Illustrating the value of this employer involvement, the mutual funds that 401(k) participants invest in are, on average, of lower cost than those that retail investors use.[40] Recognizing these benefits, an increasing number of retirees are leaving their savings in defined contribution plans after retirement, managing their money using the plan's investment options and taking periodic distributions. With the investment oversight they bring to bear, employers are providing a valuable service that employees would not be able easily or inexpensively to replicate on their own outside the plan.

Employers also typically provide educational materials about retirement saving, investing and planning, and in many instances also provide access to investment advice services.[41] To supplement educational materials and on-line resources, well over half of 401(k) plan sponsors offer in-person seminars and workshops for employees to learn more about retirement investing, and more than 40% provide communications to employees that are targeted to the workers' individual situations.[42] Surveys reveal that a significant percentage of plan participants utilize employer-provided investment education and advice tools.[43] Although participants can obtain such information outside of the workplace, it can be costly or require significant effort to do so, yielding yet another advantage to participation in an employer-sponsored defined contribution plan.

**Recent Enhancements to the Defined Contribution System Are Working**
Recent legislative reforms are improving outcomes for defined contribution plan participants. The Pension Protection Act of 2006 ("PPA"), in particular, included several landmark changes to the defined contribution system that are already beginning to assist employees in their retirement savings efforts.

Employee participation rates are beginning to increase thanks to PPA's provisions encouraging the adoption of automatic enrollment. This plan design, under which workers must opt out of plan participation rather than opt in, has been demonstrated to increase participation rates significantly, helping to move toward the universal employee coverage typically associated with defined benefit plans.[44] And more employers are adopting this design in the wake of PPA, in numbers that are particularly notable given that the IRS's implementing regulations have not yet been finalized and the Department of Labor's regulations were not finalized until more than a year after PPA's enactment.[45] One leading defined contribution plan service provider saw a tripling in the number of its clients adopting automatic enrollment between year-end 2005 and year-end 2007,[46] and other industry surveys show a similarly rapid increase in adoption by employers.[47] Moreover, many employers that have not yet adopted automatic enrollment are seriously considering doing so.[48]

Employers are also beginning to increase the default savings rate at which workers are automatically enrolled,[49] which is important to ensuring that workers have saved enough to generate meaningful income in retirement. Studies show that automatic enrollment has a particularly notable impact on the participation rates of lower-income, younger, and minority workers because these groups are typically less likely to participate in a 401(k) plan where affirmative elections are required.[50] Thus, PPA's encouragement of auto enrollment is helping to improve retirement security for these often vulnerable groups.

PPA also encouraged the use of automatic escalation designs that automatically increase an employee's rate of savings into the plan over time, typically on a yearly basis. This approach is critical in helping workers save at levels sufficient to generate meaningful retirement income and can be useful in ensuring that employees save at the levels required to earn the full employer matching contribution.[51] Employers are increasingly adopting automatic escalation features.[52]

In PPA, Congress also directed the Department of Labor (DOL) to develop guidance providing for qualified default investment alternatives, or QDIAs -- investments into which employers could automatically enroll workers and receive a measure of fiduciary protection. QDIAs are diversified, professionally managed investment vehicles and can be retirement target date or life-cycle funds, managed account services or funds balanced between stocks and bonds. There has been widespread adoption of QDIAs by employers and this has helped improve the diversification of employee investments in 401(k) and other defined contribution plans.[53] Congress also directed DOL in PPA to reform the fiduciary standards governing selection of annuity distribution options for defined contribution plans, and the DOL has recently issued final regulations on this topic.[54] As a result, fiduciaries now have a clearer road map for the addition of an annuity payout option to their plan, which can give participants another tool for translating their retirement savings into lifelong retirement income.

**Defined Contribution Plans Provide Employees with the Tools to Make Sound Investments**

As a result of legislative reform and employer practices, employees in defined contribution plans have a robust set of tools to assist them in pursuing sound, diversified investment strategies. As noted above, employers provide educational materials on key investing principles such as asset classes and asset allocation, diversification, risk tolerance and time horizons. Employers also provide the opportunity for sound investing by selecting a menu of high-quality investments from diverse asset classes that, as discussed above, often reflect lower prices relative to retail investment options.[55] Moreover, the vast majority of employers operate their defined contribution plans pursuant to ERISA section 404(c),[56] which imposes a legal obligation to offer a "broad range of investment alternatives" including at least three options, each of which is diversified and has materially different risk and return characteristics.

The development and greater use by employers of investment options that in one menu choice provide a diversified, professionally managed asset mix that grows more conservative as workers age (retirement target date funds, life-cycle funds, managed account services) has been extremely significant and has helped employees seeking to maintain age-appropriate diversified investments.[57] As mentioned above, the use of such options has accelerated pursuant to the qualified default investment alternatives guidance issued under PPA.[58] These investment options typically retain some exposure to equities for workers as they approach retirement age. Given that many such workers are likely to live decades beyond retirement and through numerous economic cycles, some continued investment in stocks is desirable for most individuals in order to protect against inflation risk.[59]

One potential challenge when considering the diversification of employee defined contribution plan savings is the role of company stock. Traditionally, company stock has been a popular investment option in a number of defined contribution plans, and employers sometimes make matching contributions in the form of company stock. Congress and employers have responded to encourage diversification of company stock contributions. PPA contained provisions requiring defined contribution plans (other than employee stock ownership plans) to permit participants to immediately diversify their own employee contributions, and for those who have completed at least three years of service, to diversify employer contributions made in the form of company stock.[60] And today, fewer employers (23%) make their matching contributions in the form of company stock, down from 45% in 2001.[61] Moreover, more employers that do so are permitting employees to diversify these matching contributions immediately (67%), up from 24% that permitted such immediate diversification in 2004.[62]

The result has been greater diversification of 401(k) assets. In 2006, a total of 11.1% of all 401(k) assets were held in company stock.[63] This is a significant reduction from 1999, when 19.1% of all 401(k) assets were held in company stock.[64]

**New Proposals for Early Access Would Upset the Balance Between Liquidity and Asset Preservation**

The rules of the defined contribution system strike a balance between offering limited access to retirement savings and restricting such saving for retirement purposes. Some degree of access is necessary in order to encourage participation as certain workers would not contribute to a plan if they were unable under any circumstances (e.g., health emergency, higher education needs, first-home purchase) to access their savings prior to retirement.[65] Congress has recognized this relationship between some measure of liquidity and plan participation rates and has permitted pre-retirement access to plan savings in some circumstances. For example, the law permits employers to offer workers the ability to take loans from their plan accounts and/or receive so-called hardship distributions in times of pressing financial need.[66] However, a low percentage of plan participants actually use these provisions, and loans and hardship distributions do not appear to have increased markedly as a result of the current economic situation.[67] To prevent undue access, Congress has limited the circumstances in which employees may take pre-retirement distributions and has imposed a 10% penalty tax on most such distributions.[68]

In 2001, as part of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), Congress took further steps to ease portability of defined contribution plan savings and combat leakage of retirement savings. EGTRRA required automatic rollovers into IRAs for forced distributions of balances of between $1,000 and $5,000 and allowed individuals to roll savings over between and among 401(k), 403(b), 457 and IRA arrangements at the time of job change.[69]

As a result of changes like these, leakage from the retirement system at the time of job change has been declining modestly over time -- although leakage is certainly an issue worthy of additional attention.[70] Participants, particularly those at or near retirement, are generally quite responsible in handling the distributions they take from their plans when they leave a company, with the vast majority leaving their money in the plan, taking partial withdrawals, annuitizing the balance or reinvesting their lump sum distributions.[71] In sum, policymakers should acknowledge the careful balance between liquidity and preservation of assets and should be wary of proposals that would provide additional ways to tap into retirement savings early.

**Defined Contribution Plan Savings is an Important Source of Investment Capital**
The amounts held in defined contribution plans have an economic impact that extends well beyond the retirement security of the individual workers who save in these plans. Retirement plans held approximately $16.9 trillion in assets as of June 30, 2008.[72] As noted earlier, amounts in defined contribution plans accounted for approximately $4.3 trillion of this amount, and amounts in IRAs represented approximately $4.5 trillion (much of which is attributable to rollovers from employer-sponsored plans, including defined contribution plans).[73] Indeed, defined contribution plans and IRAs hold nearly 20% of corporate equities.[74] These trillions of dollars in assets, representing ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital for American businesses. This capital permits greater production of goods and services and makes possible additional productivity-enhancing investments. These investments thereby help companies grow, add jobs to their payrolls and raise employee wages.

**Inquiries About Risk Are Appropriate But No Retirement Plan Design is Immune from Risk**
The recent market downturn has generated reasonable inquiries about whether participants in defined contribution plans may be subject to undue investment risk. As noted above, the American Benefits Council favors development of policy proposals and market innovations that seek to address these concerns. Yet it is difficult to imagine any retirement plan design that does not have some kind or degree of risk. Defined benefit pensions, for example, are extremely valuable retirement plans that serve millions of Americans. However, employees may not stay with a firm long enough to accrue a meaningful benefit, benefits are often not portable, required contributions can impose financial burdens on employers that can constrain pay levels or job growth, and companies on occasion enter bankruptcy (in which case not all benefits may be guaranteed).

Some have suggested that a new federal governmental retirement system would be the best way to protect workers against risk. Certain of these proposals would promise governmentally guaranteed investment returns, which would entail a massive expansion of government and taxpayer liabilities at a time of already unprecedented federal budget deficits. Other proposals would establish governmental clearinghouses or agencies to oversee retirement plan investments and administration. Such approaches would likewise have significant costs to taxpayers and would unnecessarily and unwisely displace the activities of the private sector. Under these approaches, the federal government also would typically regulate the investment style and fee levels of retirement plan investments. These invasive proposals would constrain the investment choices and flexibility that defined contribution plan participants enjoy today and would establish the federal government as an unprecedented rate-setter for many retirement investments.

Rather than focusing on new governmental guarantees or systems, any efforts to mitigate risk should instead focus on refinements to the existing successful employer-sponsored retirement plan system and shoring up the Social Security safety net.

**The Strong Defined Contribution System Can Still Be Improved**

While today's defined contribution plan system is proving remarkably successful at assisting workers in achieving retirement security, refinements and improvements to the system can certainly be made. Helping workers to manage market risk and to translate their defined contribution plan savings into retirement income are areas that would benefit from additional policy deliberations. An additional area in which reform would be particularly constructive is increasing the number of Americans who have access to a defined contribution or other workplace retirement plan. The American Benefits Council will soon issue a set of policy recommendations as to how this goal of expanded coverage can be achieved. We believe coverage can best be expanded through adoption of a multi-faceted set of reforms that will build on the successful employer-sponsored retirement system and encourage more employers to facilitate workplace savings by their employees. This multi-faceted agenda will include improvements to the current rules governing defined contribution and defined benefit plans, expansion of default systems such as automatic enrollment and automatic escalation, new simplified retirement plan designs, expanded retirement tax incentives for individuals and employers, greater use of workplace IRA arrangements (such as SIMPLE IRAs and discretionary payroll deduction IRAs), more effective promotion of existing retirement plan options, and efforts to enhance Americans' financial literacy.

## ENDNOTES

[1] Peter Brady & Sarah Holden, *The U.S. Retirement Market, Second Quarter 2008*, INVESTMENT COMPANY INST. FUNDAMENTALS 17, no. 3-Q2, Dec. 2008. This paper reveals that, as of June 30, 2008, total U.S. retirement accumulations were $16.9 trillion, a 13.4% increase over 2005 and a 59.4% increase over 2002. As noted above, these asset figures have decreased in light of recent market declines although assets held in defined contribution plans and individual retirement accounts still make up more than half of total U.S. retirement assets. *See* Brian Reid & Sarah Holden, *Retirement Saving in Wake of Financial Market Volatility*, INVESTMENT COMPANY INST., Dec. 2008.

[2] 2007 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2008 Account Balances: Estimates from Jack VanDerhei, EBRI.

[3] Press Release, Fidelity Investments, Fidelity Reports on 2008 Trends in 401(k) Plans (Jan. 28, 2009).

[4] 1999 and 2006 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2007 and 2008 Account Balances: Estimates from Jack VanDerhei, EBRI. The analysis is based on a consistent sample of 2.2 million participants with account balances at the end of each year from 1999 through 2006 and compares account balances on January 1, 2000 and November 26, 2008. *See also* Jack VanDerhei, Research Director, Employee Benefit Research Institute, What Is Left of Our Retirement Assets?, PowerPoint Presentation at Urban Institute (Feb. 3, 2009).

[5] According to the Department of Labor, there were 103,346 defined benefit plans and 207,748 defined contribution plans in 1975. In 2005, there were 47,614 defined benefit plans and 631,481 defined contribution plans. U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables* (Feb. 2008). *See also* Sarah Holden, Peter Brady, & Michael Hadley, *401(k) Plans: A 25-Year Retrospective*, INVESTMENT COMPANY INST. PERSPECTIVE 12, no. 2, Nov. 2006.

[6] A joint ICI and EBRI study projected that 401(k) participants in their late 20s in 2000 who are continuously employed, continuously covered by a 401(k) plan, and earned historical financial market returns could replace significant amounts of their pre-retirement income (103% for the top income quartile; 85% for the lowest income quartile) with their 401(k) accumulations at retirement. Sarah Holden & Jack VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?*, INVESTMENT COMPANY INST. PERSPECTIVE 8, no. 3, Nov. 2002.

[7] *Report on Retirement Plans – 2007*, Diversified Investment Advisors (Nov. 2007).

[8] *401(k) Benchmarking Survey – 2008 Edition*, Deloitte Consulting LLP (2008).

[9] In an October 2008 survey, only 2% of employers reported having reduced their 401(k)/403(b) matching contribution and only 4% said they planned to do so in the upcoming 12 months. WATSON WYATT WORLDWIDE, EFFECT OF THE ECONOMIC CRISIS ON HR PROGRAMS 4 (2008).

[10] According to one study, defined contribution plans with matching contributions have a participation rate of 73% compared with 44% for plans that do not offer matching contributions. *Retirement Plan Trends in Today's Healthcare Market – 2008*, American Hospital Association & Diversified Investment Advisors (2008). Some have wondered whether employers would reduce matching contributions as they adopt automatic enrollment since automatic enrollment is proving successful in raising participation rates. Current data suggest this is not occurring. For example, from 2005 to 2007 the number of Vanguard plans offering automatic enrollment tripled. During the same period, the percentage of Vanguard plans offering employer matching contributions increased by 4%. *How America Saves 2008: A Report on Vanguard 2007 Defined Contribution Plan Data*, The Vanguard Group, Inc. (2008); *How America Saves 2006: A Report on Vanguard 2005 Defined Contribution Plan Data*, The Vanguard Group, Inc. (2006).

[11] W. Scott Simon, *Fiduciary Focus*, Morningstar Advisor, Apr. 5, 2007.

[12] Brady & Holden (Dec. 2008), *supra* note 1.

[13] Brady & Holden (Dec. 2008), *supra* note 1.

[14] Gregory T. Long, Executive Dir., Fed. Ret. Thrift Inv. Fund, Statement Before the House Subcommittee on Federal Workforce, Postal Service, and the District of Columbia (July 10, 2008).

[15] The average 401(k) account balance increased at an annual rate of 8.7% from 1999 to 2006, despite the fact that this period included one of the worst bear markets since the Great Depression. Sarah Holden, Jack VanDerhei, Luis Alonso, & Craig Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, INVESTMENT COMPANY INST. PERSPECTIVE 13, no. 1/EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 308, Aug. 2007.

[16] Jilian Mincer, *401(k) Plans Face Disparity Issue*, WALL ST. J., Nov. 6, 2008, at D9.

[17] Fidelity Investments (Jan. 28, 2009), *supra* note 3. *See also* Reid & Holden (Dec. 2008), *supra* note 1 (noting that only 3% of defined contribution plan participants ceased contributions in 2008); *The Principal Financial Well-Being Index Summary – Fourth Quarter 2008*, Principal Financial Group (2008) (finding that, in the six months leading up to its October 2008 survey, 11% of employees increased 401(k) contributions, while only 4% decreased contributions and only 1% ceased contributions entirely); *Retirement Outlook and Policy Priorities*, Transamerica Center for Retirement Studies (Oct. 2008) (finding that participation rates are holding steady among full-time workers who have access to a 401(k) or similar employer-sponsored plan, with 77% currently participating; 31% of participants have increased their contribution rates into their retirement plans in the last twelve months; only 11% have decreased their contribution rates or stopped contributing); Press Release, Hewitt Associates, Hewitt Data Shows Americans Continue to Save in 401(k) Plans Despite Economic Woes (Nov. 24, 2008) (finding, in a November analysis, that average savings rates in 401(k) plans have only dipped by 0.2%, from 8.0% in 2007 to 7.8% in 2008).

[18] *See* Sarah Holden & Jack VanDerhei, *Contribution Behavior of 401(k) Plan Participants During Bull and Bear Markets*, NAT'L TAX ASS'N 44 (2004) (citing a number of studies which indicate little variation in before-tax contributions and a slight decrease in employer contributions as a percentage of participant pay during the 1999-2002 bear market).

[19] Principal Financial Group (2008), *supra* note 17.

[20] *Id*.

[21] *Private Pension Plan Bulletin Historical Tables* (Feb. 2008), *supra* note 5.

[22] In 2007, 82% of employers with 500 or more employees offered 401(k) plans to their employees, and 19% of these employers offered a defined contribution plan other than a 401(k) plan to their employees. *9th Annual Retirement Survey*, Transamerica Center for Retirement Studies (2008).

[23] 59% of employers with between 10 and 499 employees offered their employees 401(k) plans in 2007, as compared with 56% in 2006. Transamerica Center for Retirement Studies (2008), *supra* note 22; *8th Annual Retirement Survey*, Transamerica Center for Retirement Studies (2007).

[24] U.S. DEP'T OF LABOR & U.S. BUREAU OF LABOR STATISTICS, BULL. NO. 2715, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN THE UNITED STATES, MARCH 2008, tbl. 2 (Sept. 2008).

[25] As of December 2007, there were more than 500,000 SIMPLE IRAs. At the end of 2007, $61 billion was held in SIMPLE IRAs. *See* Brady & Holden (Dec. 2008), *supra* note 1; Peter Brady & Stephen Sigrist, *Who Gets Retirement Plans and Why*, INVESTMENT COMPANY INST. PERSPECTIVE 14, no. 2, Sept. 2008.

[26] Brady & Sigrist (Sept. 2008), *supra* note 25. *See also* U.S. DEP'T OF LABOR & U.S. BUREAU OF LABOR STATISTICS, BULL. NO. 2589, NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN PRIVATE INDUSTRY IN THE UNITED STATES, 2005 (May 2007) (indicating 8% of private-sector workers at eligible small businesses participated in a SIMPLE IRA).

[27] Among all full-time, full-year wage and salary workers ages 21 to 64, 55.3% participated in a retirement plan in 2007. This is up from approximately 53% in 2006. Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2007*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 322, Oct. 2008 (examining the U.S. Census Bureau's March 2008 Current Population Survey). *See also* The Vanguard Group, Inc. (2008), *supra* note 10 (noting that, out of all employees in Vanguard-administered plans, 66% of eligible employees participated in their employer's defined contribution plan); *51st Annual Survey of Profit Sharing and 401(k) Plans*, Profit Sharing/401(k) Council of America (Sept. 2008) (noting that 81.9% of eligible employees currently have a balance in their 401(k) plans).

[28] Participants in plans administered by Vanguard saved 7.3% of income in their employer's defined contribution plan in 2007. The Vanguard Group, Inc. (2008), *supra* note 10. Among non-highly compensated employees, the level of pre-tax deferrals into 401(k) plans has risen from 4.2% of salary in 1991 to 5.6% in 2007. Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27.

[29] *See* Transamerica Center for Retirement Studies (Oct. 2008), *supra* note 17 (finding that 35% of Echo Boomers, 34% of Generation X, 28% of Baby Boomers, and 7% of Matures consider employer-sponsored defined contribution plans as their primary source of retirement income).

[30] Jack VanDerhei, *Findings from the 2003 Small Employer Retirement Survey*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE NOTES 24, no. 9, Sept. 2003.

[31] Both small employers and workers in small businesses consider salary to be a greater priority than retirement benefits, but the inverse is true for the majority of larger employers and workers in larger businesses. *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that 56% of employees in larger businesses consider retirement benefits to be a greater priority, where 54% of employees in smaller companies rank salary as a priority over retirement benefits). *See also* Brady & Sigrist (Sept. 2008), *supra* note 25.

[32] For example, one survey found that more than half of small business respondents would be "much more likely" to consider offering a retirement plan if company profits increased. VanDerhei (Sept. 2003), *supra* note 30. *See also* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that large companies are more likely than smaller companies to offer 401(k) plans (82% large, 59% small)).

[33] It should also be remembered that those without employer plan coverage may be building retirement savings through non-workplace tax-preferred vehicles such as individual retirement accounts or deferred annuities.

[34] *See* Brady & Sigrist (Sept. 2008), *supra* note 25.

[35] Based on an analysis of the Bureau of Labor Statistics' Current Population Survey, March Supplement (2007), of those most likely to want to save for retirement in a given year, almost 75% had access to a retirement plan through their employer or their spouse's employer, and 92% of those with access participated. Brady & Sigrist (Sept. 2008), *supra* note 25.

[36] Voluntary pre-tax and Roth after-tax contributions must satisfy the Actual Deferral Percentage test ("ADP test"). The ADP test compares the elective contributions made by highly compensated employees and non-highly compensated employees. Each eligible employee's elective contributions are expressed as a percentage of his or her compensation. The numbers are then averaged for (i) all eligible highly compensated employees, and (ii) all other eligible employees (each resulting in a number, an "average ADP"). The ADP test is satisfied if (i) the average ADP for the eligible highly compensated employees for a plan year is no greater than 125% of the average ADP for all other eligible employees in the preceding plan year, or (ii) the average ADP for the eligible highly compensated employees for a plan year does not exceed the average ADP for the other eligible employees in the preceding plan year by more than 2% <u>and</u> the average ADP for the eligible highly compensated employees for a plan year is not more than twice the average ADP for all other eligible employees in the preceding plan year. Treas. Reg. § 1.401(k)-2.

Employer matching contributions and employee after-tax contributions (other than Roth contributions) must satisfy the Actual Contribution Percentage test ("ACP test"). The ACP test compares the employee and matching contributions made by highly compensated employees and non-highly compensated employees. Each eligible employee's elective and matching contributions are expressed as a percentage of his or her compensation, and the resulting numbers are averaged for (i) all eligible highly compensated employees, and (ii) all other eligible employees (each resulting in a number, an "average ACP"). The ACP test utilizes the same percentage testing criteria as the ADP test. Treas. Reg. § 1.401(m)-2.

[37] A trust shall not constitute a qualified trust under 401(a) unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards). *See* I.R.C. § 401(a)(7).

[38] *See* I.R.C. §§ 401(k)(12) and (13).

[39] ERISA § 404. I.R.C. § 401(a) also requires that a qualified trust be organized for the exclusive benefit of employees and their beneficiaries.

[40] Sarah Holden & Michael Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2007*, INVESTMENT COMPANY INST. PERSPECTIVE 17, no. 5, Dec. 2008.

[41] *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (finding that, regardless of company size, almost two-thirds of employers offer investment guidance or advice as part of their retirement plan; of those who do not currently offer guidance or advice, 18% of large employers and 7% of small employers plan to offer advice in the future); Deloitte Consulting LLP (2008), *supra* note 8 (51% of 401(k) sponsors surveyed offer employees access to individualized financial counseling or investment advice services (whether paid for by employees or by the employer)); *Trends and Experience in 401(k) Plans 2007 – Survey Highlights*, Hewitt Associates LLC (June 2008) (40% of employers offer outside investment advisory services to employees).

[42] Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27.

[43] 46% of plan participants consulted materials, tools, or services provided by their employers. John Sabelhaus, Michael Bogdan, & Sarah Holden, *Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007*, INVESTMENT COMPANY INST. RESEARCH SERIES, Fall 2008.

[44] *See, e.g.*, *Measuring the Effectiveness of Automatic Enrollment*, Vanguard Center for Retirement Research (Dec. 2007) (stating that "[a]n analysis of about 50 plans adopting automatic enrollment confirms that the feature does improve participation rates, particularly among low-income and younger employees"); Deloitte Consulting LLP (2008), *supra* note 8 (stating that "[a] full 82% of survey respondents reported that auto-enrollment had increased participation rates"); *Building Futures Volume VIII: A Report on Corporate Defined Contribution Plans*, Fidelity Investments (2007) (stating that in 2006 overall participation rates were 28% higher for automatic enrollment-eligible employees than for eligible employees in plans that did not offer automatic enrollment; overall, automatic enrollment eligible employees had an average participation rate of 81%).

[45] A recently-surveyed panel of experts expects automatic enrollment to be offered in 73% of defined contribution plans by 2013. *Prescience 2013: Expert Opinions on the Future of Retirement Plans*, Diversified Investment Advisors (Nov. 2008).

[46] *See* The Vanguard Group, Inc. (2008), *supra* note 10.

[47] *See* Deloitte Consulting LLP (2008), *supra* note 8 (42% of surveyed employers have an automatic enrollment feature compared with 23% in last survey); Hewitt Associates LLC (June 2008), *supra* note 41 (34% of surveyed employers have an automatic enrollment feature compared with 19% in 2005); Profit Sharing/401(k) Council of America (Sept. 2008), *supra* note 27 (more than half of large plans use automatic enrollment and usage by small plans has doubled).

[48] *See* Deloitte Consulting LLP (2008), *supra* note 8 (stating that 26% of respondents reported they are considering adding an auto-enrollment feature).

[49] One leading provider has noted an upward shift since 2005 in the percentage of sponsors that use a default deferral rate of 3% or higher, and a corresponding decrease in the percentage of sponsors that use a default deferral rate of 1% or 2%. The Vanguard Group, Inc. (2008), *supra* note 10.

[50] *See, e.g.*, Copeland (Oct. 2008), *supra* note 27 (noting that Hispanic workers were significantly less likely than both black and white workers to participate in a retirement plan); Jack VanDerhei & Craig Copeland, *The Impact of PPA on Retirement Savings for 401(k) Participants*, EMPLOYEE BENEFIT RESEARCH INST. ISSUE BRIEF, no. 318 (June 2008) (noting that industry studies have shown relatively low participation rates among young and low-income workers); Fidelity Investments (2007), *supra* note 44 (stating that, in 2006, among employees earning less than $20,000, the participation boost from automatic enrollment was approximately 50%); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-8, PRIVATE PENSIONS: LOW DEFINED CONTRIBUTION PLAN SAVINGS MAY POSE CHALLENGES TO RETIREMENT SECURITY, ESPECIALLY FOR MANY

LOW-INCOME WORKERS (Nov. 2007); Daniel Sorid, *Employers Discover a Troubling Racial Split in 401(k) Plans*, WASH. POST, Oct. 14, 2007, at F6.

[51] *See* Fidelity Investments (2007), *supra* note 44 (noting that, in 2006, the average deferral rate for participants in automatic escalation programs was 8.3%, as compared to 7.1% in 2005).

[52] *See* The Vanguard Group, Inc. (2008), *supra* note 10 (post-PPA, two-thirds of Vanguard's automatic enrollment plans implemented automatic annual savings increases, compared with one-third of its plans in 2005); Hewitt Associates LLC (June 2008), *supra* note 41 (35% of employers offer automatic contribution escalation, compared with 9% of employers in 2005); Transamerica Center for Retirement Studies (2008), *supra* note 22 (26% of employers with automatic enrollment automatically increase the contribution rate based on their employees' anniversary date of hire).

[53] A leading provider states that "QDIA investments are often more broadly diversified than portfolios constructed by participants. Increased reliance on QDIA investments should enhance portfolio diversification." The Vanguard Group, Inc. (2008), *supra* note 10. *See also* Fidelity Investments (2007), *supra* note 44 (where a lifecycle fund was the plan default option, overall participant asset allocation to that option was 19.4% in 2006; where the lifecycle fund was offered but not as the default option, overall participant asset allocation to that option was only 9.8%).

[54] Selection of Annuity Providers: Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447 (Oct. 7, 2008) (to be codified at 29 C.F.R. pt. 2550).

[55] *See* Holden & Hadley (Dec. 2008), *supra* note 40.

[56] One survey found that 92% of companies surveyed stated that their plan is intended to comply with ERISA section 404(c). Deloitte Consulting LLP (2008), *supra* note 8.

[57] In 2006, the percentage of single investment option holders who invested in lifecycle funds – "blended" investment options – was 24%. 42% of plan participants invested some portion of their assets in lifecycle funds. The average number of investment options held by participants was 3.8 options in 2006. Fidelity Investments (2007), *supra* note 44.

[58] In 2007, 77% of employers offered lifecycle funds as an investment option, compared with 63% in 2005. Hewitt Associates LLC (June 2008), *supra* note 41. *See also* Fidelity Investments (2007), *supra* note 44 (noting that, in 2006, 19% of participant assets were invested in a lifecycle fund in plans that offered the lifecycle fund as the default investment option, compared with 10% of participant assets in plans that did not offer the lifecycle fund as the default investment option).

[59] *See Target-Date Funds: Still the Right Rationale for Investors*, The Vanguard Group, Inc. (Nov. 28, 2008) (noting that "even investors entering and in retirement need a significant equity allocation" and citing the 17- to 20-year life expectancy for retirees who are age 65). *See also* Fidelity Investments (2007), *supra* note 44 ("In general . . . the average percentage of assets invested in equities decreased appropriately with age . . . to a low of 45% for those in their 70s.").

[60] I.R.C. § 401(a)(35); ERISA § 204(j).

[61] Hewitt Associates LLC (June 2008), *supra* note 41.

[62] Hewitt Associates LLC (June 2008), *supra* note 41.

[63] Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15. *See also* Fidelity Investments (Jan. 28, 2009), *supra* note 3 (noting that, at year-end 2008, company stock made up approximately 10% of Fidelity's overall assets in workplace savings accounts, compared with 20% in early 2000).

[64] Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15. *See also* William J. Wiatrowski, *401(k) Plans Move Away from Employer Stock as an Investment Vehicle*, MONTHLY LAB. REV., Nov. 2008, at 3, 6 (stating that (i) in 2005, 23% of 401(k) participants permitted to choose their investments could pick company stock as an investment option for their employee contributions, compared to 63% in 1985, and (ii) in 2005, 14% of 401(k) participants permitted to choose their investments could pick company stock as an investment option for employer matching contributions, compared to 29% in 1985).

[65] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO/HEHS-98-2, 401(K) PENSION PLANS: LOAN PROVISIONS ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME (Oct. 1997) (noting that plans that allow borrowing tend to have a somewhat higher proportion of employees participating than other plans).

[66] *See* I.R.C. §§ 72(p) and 401(k)(2)(B).

[67] *See, e.g.*, Reid & Holden (Dec. 2008), *supra* note 1 (stating that, in 2008, 1.2% of defined contribution plan participants took a hardship withdrawal and 15% had a loan outstanding); Fidelity Investments (Jan. 28, 2009), *supra* note 3 (noting that only 2.2% of its participant base initiated a loan during the fourth quarter of 2008, compared with 2.8% during the fourth quarter of 2007, and 0.7% of its participant base took a hardship distribution during the fourth quarter of 2008, compared with 0.6% during the fourth quarter of 2007); Holden, VanDerhei, Alonso, & Copeland (Aug. 2007), *supra* note 15 (noting that most eligible participants do not take loans); Fidelity Investments (2007), *supra* note 44 (noting that only 20% of active participants had one or more loans outstanding at the end of 2006). Most participants who take loans repay them. *See* Transamerica Center for Retirement Studies (2008), *supra* note 22 (only 18% of participants have loans outstanding, and almost all participants repay their loans).

[68] I.R.C. § 72(t).

[69] *See* I.R.C. § 402(c)(4).

[70] In 2007, among participants eligible for a distribution due to a separation of service, 70% chose to preserve their retirement savings by rolling assets to an IRA or by remaining in their former employer's plan, compared with only 60% in 2001. The Vanguard Group, Inc. (2008), *supra* note 10; *How America Saves 2002: A Report on Vanguard Defined Contribution Plans*, The Vanguard Group, Inc. (2002).

[71] *See* Sabelhaus, Bogdan, & Holden (Fall 2008), *supra* note 43 (stating that retirees make prudent choices at retirement regarding their defined contribution plan balances: 18% annuitized their entire balance, 6% elected to receive installment payments, 16% deferred distribution of their entire balance, 34% took a lump sum and reinvested the entire amount, 11% took a lump sum and reinvested part of the amount, 7% took a lump sum and spent all of the amount, and 9% elected multiple dispositions; additionally, only about 3% of accumulated defined contribution account assets were spent immediately at retirement).

[72] Brady & Holden (Dec. 2008), *supra* note 1.

[73] *Id.* It is highly doubtful that Americans would have saved at these levels in the absence of defined contribution plans given the powerful combination of pre-tax treatment, payroll deduction, automatic enrollment and matching contributions.

[74] *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL RESERVE STATISTICAL RELEASE Z.1, FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES (December 11, 2008); Brady & Holden (Dec. 2008), *supra* note 1.