



AMERICAN BENEFITS COUNCIL

February 13, 2009

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

Employer-sponsored 401(k) and other defined contribution retirement plans are a core element of our nation's retirement system and successfully assist tens of millions of families in accumulating retirement savings. Congress has adopted rules that facilitate employer sponsorship of these plans, encourage employee participation, promote prudent investing, allow operation at reasonable cost, and safeguard participant interests through strict fiduciary obligations. While individuals have understandable retirement income concerns resulting from the recent economic downturn, it is critical to acknowledge the vital role these plans play in ensuring 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 grown dramatically in number, asset value, and employee participation. There are now more than 630,000 private-sector defined contribution plans covering more than 75 million active and retired workers. In addition, more than 10 million employees of tax-exempt and governmental employers participate in 403(b), 457 and TSP defined contribution plans. Private-sector and governmental defined contribution plans held more than \$4 trillion in combined assets as of June 2008. Of course, assets have declined significantly since then due to the downturn in the financial markets with the average 401(k) account balance down 27% in 2008. Yet 401(k) account balances are still up 140% since January 1, 2000, a period that has included two bear markets. Together with Social Security, defined contribution plan accumulations enable retirees to replace a significant percentage of pre-retirement income (and many workers, of course, will also have income from defined benefit plans).
- **Defined Contribution 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 judge defined contribution plans based on whether they serve workers' retirement interests over the long term. If historical trends continue, plan participants who remain in the system can expect their plan account balances to rebound and grow significantly over time. Indeed, one of the benefits of regular payroll deduction is

that employees who select equity vehicles purchase these investments at varying prices as markets rise and fall, achieving effective dollar cost averaging. In the face of the current economic crisis, the vast majority of plan participants remain committed to saving in their defined contribution plans.

- **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. Yet many employers make matching, non-elective, and profit-sharing contributions to complement employee deferrals and share the responsibility for financing retirement. Indeed, recent surveys of defined contribution plan sponsors found that at least 95% make some form of employer contribution. While certain employers are suspending matching contributions due to the current economic downturn and a spike in defined benefit plan funding obligations, the vast majority are not.
- **Employer Sponsorship Offers Advantages to Employees.** Employer sponsors of defined contribution plans must adhere to strict fiduciary obligations established by Congress to protect the interests of plan participants. These demanding fiduciary obligations offer investor protections not typically associated with non-workplace savings vehicles. One way in which employers exercise oversight and add value is through selection of plan investment options. Employers focus on selecting high-quality, reasonably-priced investment options from diverse asset classes and then monitoring these options on an ongoing basis. To make investing simpler for employees, employers also increasingly offer single-fund diversified investment options that grow more conservative with age. In addition, employers provide educational materials and workshops about saving and investing and many offer access to professional investment advice, yielding yet another set of advantages relative to non-workplace savings vehicles.
- **Defined Contribution Plan Coverage and Participation Rates Are Increasing.** Today, the vast majority of large employers offer a defined contribution plan and an increasing number of small employers do as well. The number of employees participating in these plans grew from 11.5 million in 1975 to more than 75 million in 2005, and 65% of full-time employees in private industry had access to a defined contribution plan in 2008. Expanding plan coverage is certainly a worthy goal, and the American Benefits Council will soon make policy recommendations in that regard. Where employees do have access to a plan, participation rates and savings levels have increased modestly over time, with both expected to increase further as more plans adopt automatic enrollment and automatic contribution escalation.
- **Defined Contribution Plan Rules Promote Benefit Fairness.** Congress has established detailed rules to ensure that benefits in defined contribution plans are delivered across all income groups. Extensive coverage, nondiscrimination and top-heavy rules promote fairness regarding which employees are covered by a defined contribution plan and the contributions made to these plans.

- **401(k) Plans Have Evolved in Ways That Benefit Workers.** Over the past 15 years, Congress has enacted repeated enhancements to 401(k) plans, aiding their evolution from bare-bones savings plans into retirement plans. Among these enhancements have been incentives for plan creation, catch-up contributions for older workers, accelerated vesting schedules and tax credits for retirement savings. Private innovation has also been significant, with plan sponsors and service providers developing many features, including automatic contribution escalation, single-fund investment solutions and investment education programs. These legislative changes and market innovations have improved both employee participation rates and employee outcomes.
- **Recent Enhancements to the Defined Contribution System Are Working.** The Pension Protection Act of 2006 (PPA) included several landmark changes to the defined contribution system that are already beginning to assist employees. PPA encouraged automatic enrollment (which studies demonstrate significantly increases participation rates, particularly among lower-income, younger, and minority workers) and automatic contribution escalation. Adoption of these features has increased dramatically. In PPA, Congress provided new rights to diversify contributions made in company stock, accelerating existing trends toward greater diversification of 401(k) assets. Congress in PPA also directed the Department of Labor to issue several sets of regulations, and the resulting guidance has encouraged the use of employee-friendly single-fund investment solutions and made it easier for employers to add lifetime income options to their plans.
- **Defined Contribution Plan Savings is an Important Source of Investment Capital.** Defined contribution plan assets have an economic impact that extends well beyond the retirement security of individual workers. The trillions of dollars of assets in these plans, representing ownership of a significant share of the total pool of stocks and bonds, provide an important and ready source of investment capital to help American businesses grow.
- **Inquiries About Risk Are Appropriate But No Retirement Plan Design is Immune from Risk.** The recent market downturn has spawned questions about whether defined contribution plan participants may be subject to undue investment risk, and this is a particularly sensitive and important issue for those nearing retirement. Yet it is difficult to imagine any retirement plan design, including the defined benefit plan, that does not have some kinds of risk. Some have suggested that a new federal governmental retirement system with guaranteed returns would be the best way to protect workers against risk, but such proposals have their own risks in the form of massive expansions of government and taxpayer liabilities. Instead, any efforts to mitigate risk should focus on refinements to the existing successful employer-sponsored retirement plan system and shoring up the Social Security safety net.