### **Research Highlights**

## Trends and Experience in 401(k) Plans

The 2009 *Trends and Experience in 401(k) Plans* survey results reveal emerging trends in 401(k) plan design and administration.

Hewitt Associates conducted the biennial survey in the summer of 2009. Information on key aspects of 401(k) design, investments, education, communication, plan expenses, and plan success was collected from a cross-section of plan sponsors.

More than 300 employers participated in the survey, sharing information on the plan that covers the largest number of their salaried employees. Participants include 25% of the Fortune 500®. The surveyed plans have a combined total of approximately 3.8 million participants and nearly \$350 billion in assets.

The *Trends and Experience in 401(k) Plans* survey has been conducted every other year since 1991. While the focus of the survey and survey samples has changed over the years, there are still a number of areas where useful comparisons and trends across time can be examined. The full report shows such comparisons and trends throughout the past several years. These results do not represent a constant sample of employers.

Please note that percentages in this report are rounded to the nearest whole number. Therefore, some totals will not equal 100 percent.

#### **Executive Summary**

With increasing importance placed on the 401(k) industry to deliver retirement income, the 401(k) plan environment continues to be dynamic. Some new trends emerged, while many existing trends accelerated. Employers increasingly design their 401(k) plans in a way that encourages positive saving and investing behaviors and helps employees meet their increasing retirement income needs.

Employers have increased efforts to automate their 401(k) plans and default employees in a way that leads to better potential long-term outcomes. This change is evident by the significant increases in automatic features, such as automatic enrollment, automatic contribution escalation, and automatic rebalancing. Further, defaults under automatic enrollment have continued to migrate to diversified investment options. The impact of automatic enrollment on participation rates continues to be gradual given that a vast majority of plans with automatic enrollment mostly default only to new hires, as opposed to existing nonparticipants.

The way employers measure success has shifted in the recent economic environment, with six out of ten plan sponsors now ranking adequate performance of investments and the plan being valued and appreciated by employees as the two most important measures. Additionally, retirement income security and participation rate are also ranked relatively high.

The 2008 financial crisis has had a significant impact on some companies, as employer contributions have been decreased, temporarily suspended, or eliminated among a minority of companies. That being said, many employers are providing employees with the ability to start saving in their 401(k) savings plan more quickly than in years past, and thus leverage the employer match sooner.

Investment fund design continues to be more simplified and streamlined. Clearly, a tiered structure has grown in prevalence, with target-date portfolios and self-directed brokerage windows growing substantially. Further, while the number of funds offered in the plan has risen in total, the bulk of this movement has been from the adoption of target-date portfolios.

When it comes to selecting funds, nearly six out of ten employers ranked investment fees/expense ratio as the most important factor in selecting investment options for their 401(k) plans. As a result, non-mutual fund alternatives, including collective trusts and separate accounts, have gained momentum as employers seek alternatives to mutual funds. Index funds have also grown in prevalence in the past two years.

Many companies are offering funds and advice tools that simplify investment decisions and help employees make wise choices. The prevalence of target-date portfolios and outside investment advisory services—including advice, guidance, and/or managed accounts—has increased significantly in the past two years.

Finally, plan expenses are top of mind with employers, with nearly seven out of ten plan sponsors indicating they are concerned about the topic. In recent years, fees have gained significant attention among the media, regulators, and litigators. Many plan sponsors have analyzed their current fee structure as well as the appropriate way(s) to communicate these messages to employees.

Additional detail on these and other trends are summarized below.

#### **Detailed Findings**

#### **Basic Design and Participation**

401(k) plans will clearly be the predominant source of retirement wealth for most Americans. Two-thirds of employers (67%) report that the 401(k) plan is the primary retirement savings vehicle for the employees they cover. This has leveled off in the past few years after rising for more than a decade.

In the past two years, employers continued to shift away from defined benefit pension plans (23%) and retiree medical subsidies (21%). Many of those same employers have simultaneously enhanced the 401(k) plan, most often through introducing or increasing a 401(k) matching contribution (17%) and/or nonmatching contribution (15%).

#### **Key Findings:**

- Two-thirds of employers report that the 401(k) plan is the primary retirement savings vehicle for employees.
- Employers continued to shift away from defined benefit plans and medical subsidies, although many increased matching contributions (17%) and/or nonmatching contributions (15%).
- Seventeen percent of plans have decreased, temporarily suspended, or eliminated employer matching contributions.

Employers are providing earlier access to 401(k) savings, with more than half of plans (52%) offering immediate eligibility to participate in the 401(k) plan. Seventy-four percent of plans do not have any service requirements for participating in a 401(k) plan, up from 61% in 2007. Participants are also receiving employer matching contributions earlier than before; 56% of plans do not have any service requirements for participants to receive employer matching contributions, up from 44% in 2007.

On the other hand, 10% of companies temporarily suspended employer matching contributions since 2007 and an additional 10% of companies temporarily suspended nonmatching profit sharing contributions (7%) and employer nonmatching contributions (3%).

Even with the economic downturn, participation has increased gradually in the past few years due primarily to automatic enrollment.

On average, 81% of eligible employees participate in their companies' 401(k) plans, which is up 3 percentage points from 2007 and 6 percentage points from 2005. Interestingly, nearly half of the plans had participation rates higher than 90% in 2009, which represents nearly a 10 percentage point increase from 2007.

#### **Automatic Features**

Automation is becoming the standard in 401(k) plans. The percentage of employers that automatically enroll participants increased substantially from 34% in 2007 to 58% in 2009. Similarly, automatic contribution escalation, where employees can elect to have their contribution rates automatically increased over time without any additional action, increased to 44% of employers, up from 35% in 2007. Forty-seven percent of respondents now offer automatic rebalancing, compared to only 42% in 2007.

#### **Key Findings:**

- Automatic enrollment jumped dramatically from 34% in 2007 to 58% in 2009.
- Defaults under automatic enrollment migrated—69% of plans now default to target-date funds (up from 50%). Further, 40% of plans couple automatic escalation with automatic enrollment (up from 28%).
- Automatic contribution escalation increased to 44% of plans, and automatic rebalancing is offered in 47% of plans.

Investment defaults under automatic enrollment have shifted to diversified investment options. Currently, 69% of plans default participants' funds into a target-date fund, up from 50% in 2007. Conversely, only 5% of plans default into money market or stable value funds, down from 17% in 2007. Additionally, 35% of employers set their default contribution rates at 4% or higher, up slightly from the 2007 survey. Four out of ten employers (40%) use contribution escalation in conjunction with automatic enrollment, up significantly from 28% in 2007. Half of these employers are escalating employees to target rates between 8% and 15%, up from 45% in 2007.

#### **Employee and Employer Contributions**

Almost all responding employers contribute employer money to their plans, and nearly two-thirds provide a fixed employer matching contribution. The most common type of fixed match in this year's survey, reported by 27% of employers, is \$1.00 per \$1.00 up to a specified percentage of pay (commonly 6% of pay). Previous surveys have found the most common fixed match formula is \$0.50 per \$1.00 up to a specified percentage of pay (most commonly 6% of pay), reported by 23% of all plans with a fixed matching contribution, down from 26% in 2007.

The downward trend continues among plans that offer employer stock as an investment option—only 17% of employers invest the employer matching contribution exclusively in company stock. This is down from 23% in 2007 and 36% in 2005. Further, of those that do default the match exclusively to employer stock, there are fewer restrictions associated. Currently, 84% of these plans allow employees to diversify or transfer employer matching contributions at any time. This is up considerably from 67% in 2007 and from 46% in 2005.

#### **Key Findings:**

- Nearly two-thirds of plans provide employer matching contributions. Most common this year is dollar-for-dollar up to a specified percentage of pay (commonly up to 6%).
- Employer stock continues to be used in conjunction with matching contributions.

  Among plans that offer company stock, only 17% match in company stock.

  Further, of those that do match, 84% allow employees to diversify immediately.

#### **Investment Options**

The process of selecting and monitoring investment options continues to be top of mind with employers. Nine out of ten plans (90%) have a written investment policy statement, up from 83% in 2007 and 78% in 2005. A written investment policy statement helps provide a framework for decision making.

When it comes to selecting funds, nearly six out of ten employers (59%) rank investment fees/ expense ratio as one the most important factors in selecting investment options for their 401(k) plans. Historical performance was the number-one factor in 2007. Fund objective and style consistency garnered the second most responses with nearly half of respondents (48%) ranking it as the most important factor, while 47% of respondents ranked historical investment performance as important when selecting investment options.

#### **Key Findings:**

- Ninety percent of plans have a written investment policy statement.
- When selecting funds, nearly 60% of plans rank fees/expenses as one of the most important factors.
- Investment fund options are increasingly streamlined and tiered:
  - -Target-date funds are offered by 78% of plans (up from 58% in 2007).
  - The median number of core funds, excluding target-date funds, is 12 funds.
     Much of the change is due to index fund adoption and specialty-type funds such as TIPS and REITs.
  - —Twenty-six percent of plans offer access to a self-directed brokerage window, up from 18%.

A simplified, more streamlined investment fund structure is emerging. Currently, 78% of plans now offer target-date portfolios, up from 58% in 2007 and 28% in 2005.

While the average number of investment options increased from 17 to 20 in the past two years, much of this is due to adoption of target-date portfolios. The median number of funds is only 12, up from 11 in 2007.

The most popular asset classes offered remained steady in this year's survey with stable value (83%), intermediate bond (94%), large-cap U.S. equity (99%), and international equity (98%) funds. Employer stock is an investment option within 47% of plans. The percentage of plans that offer money market funds increased significantly in the past two years, partly due to the financial crisis in 2008, when participants were looking for a safe haven in treasuries. Specialty bonds also saw a 10 percentage point increase in the past two years, largely due to the increasing adoption of TIPS. In addition, the percentage of plans with REIT funds is up 9 percentage points from 2007. Index funds also gained significant momentum in the past two years.

In terms of asset allocation, the bulk of 401(k) assets remains invested in stable value (26%), large-cap U.S. equity (19%), and employer stock (16%) funds. The overall allocation to fixed income funds increased significantly, largely due to the 2008 financial market crisis. In terms of the types of vehicles offered in 401(k) plans, non-mutual fund alternatives, including collective trusts and separate accounts, are used more heavily by employers—with nearly a third of plans offering more than half of their funds in an institutional format. The upward trend continued toward plan sponsors offering self-directed brokerage windows, which increased

from 18% in 2007 to 26% in 2009. Access to a brokerage window can be an effective way for plans to consolidate fund options and still allow greater choice for the small subset of employees who desire this type of access.

#### **Investment Education**

Consistent with the previous surveys, the vast majority of employers (90%) continue to provide investment education to their employees. Nearly all respondents use written materials for communicating investment concepts, and 76% report that they are somewhat effective. Eighty-six percent of plan sponsors use on-site seminars/workshops in their education efforts, and 46% report that they are very effective.

More companies are helping their employees make wise investment decisions by offering independent financial advice and education. Half of employers offer outside investment advisory services to employees (including advice, guidance, and managed accounts). This is up from 40% in 2007 and 37% in 2005. An additional 9% of employers plan to add this service in the next 12 months. One-third of employers offer seminars/workshops and

#### **Key Findings:**

- A vast majority of plans (90%) provide investment education to employees.
- Half of employers now offer outside investment advisory services to employees, and 9% plan to add. There was growth in most areas, including:
  - -One-third offered online advice (31%).
  - -Managed accounts are offered by 26% of plans, up from 11% in 2007.
  - Online guidance is offered by 28% of plans.

online advice to participants, up from 20% in 2007. There is also a significant increase in the percentage of plans offering one-on-one financial counseling and online guidance. Managed accounts more than doubled—offered by 26% of plans, up from 11% in 2007. Among those employers not offering outside investment advice, the most prevalent barrier cited was legal/fiduciary concerns (62%) and cost issues (20%).

#### **Plan Expenses**

An increasing number of employers are focusing more closely on 401(k) plan fees. Nearly seven out of ten employers (69%) noted they are very or somewhat concerned about expenses amid the recent scrutiny of the government and media, as well as concerns of potential litigation. This number has slightly increased since the 2007 survey when 61% of employers noted they were very or somewhat concerned about plan expenses.

Perhaps in response to these concerns, 84% of employers said that they have attempted to calculate the total cost of maintaining the 401(k) plan—an increase from 60% in 2007 and 29% back in 2001. Complexity is quoted as the number-one reason why employers have not calculated total plan cost.

#### **Key Findings:**

- Nearly 70 percent of plans are somewhat or very concerned about fees amid the recent scrutiny.
- The number of plans calculating total plan cost increased dramatically from 60% to 84% of employers.
- Nearly three-quarters of plans have made efforts to reduce fees in the past two years.

Nearly three-quarters of employers (74%) have made efforts to reduce expenses, up from 57% in 2007. These efforts include negotiating with their current service provider to reduce fees (66%), swapping out funds for lower-cost alternatives (51%), and working with fund managers for alternative pricing (through collective trusts and separate accounts) (18%).

Sixty percent of employers report that fees associated with their 401(k) plans are evaluated internally. More than one-quarter of employers (28%) disclose administrative fees only upon a participant's request. For investment management fees, 65% of plan sponsors note that they disclose fees in fund fact sheets and/or prospectus information. These findings are consistent with the 2007 survey.

## Retirement Income Solutions, Loans, and Plan Distributions

Retirement income solutions, such as annuities within the 401(k) plan and individual insurance products, are emerging as new options for plan participants. Only 7% of employers report offering annuities within the plan while another 2% report planning to add this feature in the next year. One percent of employers currently offer individual insurance products such as variable annuity features, preservation of principal, and minimum annuity payout; 1% plan to add these options in the next year.

Nearly all of the surveyed plans (97%) have a loan provision, with 99% of these plans offering general purpose loans and 77% offering home loans. These numbers are consistent with previous surveys. It is most common for plans to offer one or two outstanding loans.

#### **Key Findings:**

- Seven percent of plans report offering annuities within the plan, and another 2% plan to add in the next year.
- Loans and hardship withdrawal capabilities are offered by the vast majority of plans.

Most plans (95%) have a hardship withdrawal provision, and this is consistent with the previous surveys. Further, 91% of plans allow inservice withdrawals for participants who have attained age  $59\frac{1}{2}$ .

All plans surveyed offer lump-sum payments, more than half offer installment payments, and 14% offer annuities as forms of payment for final distributions. Additionally, 60% of plans support automatic force-out rollovers in their defined contribution plans.

#### **ADP/ACP Tests**

Three out of ten employers (31%) report using a safe harbor design in lieu of ADP/ACP testing, up from 29% in 2007. Among those that use a safe harbor design, 15% use the pre-Pension Protection Act safe harbor formula while 16% use the Pension Protection Act safe harbor formula. More than half of plan sponsors (54%) expected to pass the 2008 401(k) ADP test

#### **Key Findings:**

- Safe harbor design is used instead of ADP/ACP testing with 31% of plans; 15% use the pre-PPA safe harbor formula, while 16% use the PPA formula.
- More than half of plans doing testing expect to pass.

without adjustment to highly compensated employees' (HCEs') contributions. At the same time, nearly one-quarter (24%) anticipated limiting the percentage of pay that HCEs may contribute in order to pass the nondiscrimination test. These findings are consistent with previous surveys.

#### **Participating Employer Information**

Half of employers that participated in the 2009 survey have 10,000 or more employees. This is similar to previous surveys. The median size of participating employers is 9,800 employees, and the average size is 24,900 employees. The plans in the survey represent approximately 3.8 million participants and \$348 billion in plan assets. Twenty-five percent of employers that participated in this survey are ranked as *Fortune 500* companies. The stocks of eight out of ten survey respondents (81%) are publicly traded. This is consistent with previous surveys.

#### **Key Findings:**

- 302 plans were surveyed, representing 3.8 million participants and nearly \$350 billion in plan assets.
- The median size of respondents is 9,800 employees, and the average is 24,900 employees.

#### **For More Information**

If you would like more information on this research, please email us at **peoplesolutions@hewitt.com** 

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