

Visit **Benefits and Pensions Monitor** magazine online at: <http://www.bpmmagazine.com>

---

## **U.S. Sponsors Address 401(k) Failings**

By: **Benefits and Pensions Monitor** Staff

With U.S. workers depending more on 401(k) **pension plans** to provide income in **retirement**, U.S. **pension plan** sponsors are identifying and trying to overcome what are now being seen as serious shortcomings in the **Defined Contribution pension** plan structure, says a Greenwich Associates report. Its 2007 report on U.S. **Defined Contribution retirement** plans says **plan sponsors** are turning to products and strategies designed to transform their **DC plans** into more effective **retirement** savings vehicles for their employees,

The growing importance of **DC plans** in the **retirement** savings plan of U.S. workers is a result of the decline of the **Defined Benefit pension plan** in the U.S. About 22 per cent of U.S. corporate **DB plans**, including more than a quarter of the largest (those with more than \$5 billion in plan assets), are now closed to new employees. Where once **DC plans** were used to supplement traditional **DB pension plans**, they are now the only **pension plan** available.

When **DC plans** were just a supplement to the **DB plan**, their deficiencies were overlooked or “simply accepted as intrinsic to the **DC** structure,” says the Greenwich report.

### **Retirement Security**

Now, however, plan sponsors are realizing the importance of their DC plans to the retirement security of their employees.

“This is an issue of paramount importance not only to plan sponsors, employees and retirees, but to the nation as a whole,” says Greenwich Associates consultant Will Wechsler says. “At exactly the time that medical science is extending life spans, the systems that have served as the traditional foundation for retirement funding – Social Security and DB pension plans – are weakening. The country is counting on DC plans to take their place, and as such, the deficiencies built into the DC plan structure must be overcome. There is no room for error.”

One of the key deficiencies of the DC plan starts when an employee joins a new company. In the past, when DC was not a central element of retirement savings, the voluntary aspect of these plans made them a benefit in that they gave the employee the flexibility to decide if they wanted to augment their retirement savings or not.

However, the evidence now shows that asking employees to proactively enroll in a retirement plan significantly depresses participation, leaving many employees with no pension plan of any kind.

Another realization is that the long-term investment returns in these plans may fall short of expectations since many participants lack the financial expertise needed to properly manage their plan and save for retirement.

### **Ongoing Struggle**

This, in turn, is the result of the ongoing struggle faced by plan sponsors and their providers to find cost-effective ways to deliver the education and advice plan members need to properly manage their DC plan.

To deal with the issue of a lack of participation, many sponsors are turning to automatic enrolment. Roughly 20 per cent of companies with DC plan assets of \$250 million or more have adopted automatic enrolment and another 17 per cent say they have plans to incorporate the provision. At smaller plans, adoption has been even faster as 28 per cent use automatic enrolment and another 24 per cent plan to start.

Plans which opt for automatic enrolment also need to have a suitable default. For a growing number, the choice is target retirement date funds and life cycle funds. With the target date fund, professional portfolio managers design and adjust asset allocations over a window defined by a 'target' retirement date. Life cycle funds operate in a similar fashion, however, the adjustments are made based on individual risk tolerances and other considerations.

These funds also help resolve the issue of educating plan members to make informed investment choices and to manage their plans as the management of these funds is done by professional managers.

Plan sponsors are also demonstrating their commitment to DC plans on a more fundamental level. They are increasing their own contributions. Some 95 per cent of U.S. companies with plan assets of more than \$250 million make matching contributions to their DC plans, as do 84 per cent of smaller plans.

"DC plan sponsors are adopting automatic enrolment, they are incorporating products that improve investment returns throughout the course of an employee's working years, they are switching to institutional products that minimize fees, and they are taking steps to maximize both their own contributions and those of participants," says Greenwich Associates consultant Chris McNickle. "All of these steps will help improve the economic condition of the nation's retirees."