

“The United States: The Development and Experience with 401(k) Plans

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Employee Benefit
Research Institute

Outline

1. Basic design and operation of the defined contribution plan
2. The way in which matching contributions are used in the system
3. Overall patterns of coverage and the impact of matching contributions on participation (plus auto enroll, etc.)
4. The effect of employers dropping matching contributions during the recent recession
5. Account balances now relative to before the recession
6. What could they deliver in the future – depending upon workforce factors.
7. Reform and the future

1. Basic design and operation of defined contribution plans

Brief Chronology of the Development of the 401(k) plan in the US

- **Genesis -- 1978**
 - Section 401(k) added to IRC
- **Expansion to salary deferrals -- November 1981**
 - Proposed regulations
- **Constraints added in the 1980's***
 - 402(g) limit
 - ADP/ACP nondiscrimination tests
 - Restrictions on hardship withdrawals
- **Flexibility added in the 1990's**
 - Safe-harbor plans (might want to mention SIMPLE plans too but I don't think you will have enough time)
 - Automatic enrollment
- **The last ten years**
 - Catch up contributions
 - Roth 401(k)
 - PPA and the mitigation of administrative concerns for automatic enrollment
 - Increase in percentage of 401(k) plans using automatic enrollment and auto escalation of contributions
 - QDIA regulations
 - The rise of TDFs
 - 2008/9 market crises
 - Enron and the appropriateness of company stock

Basic Design and Operation of Defined Contribution Plans

1. Voluntary employer decision to sponsor any plan
2. Contributions are deductible for employer and individual tax is deferred until funds are withdrawn for individual
3. Workers can make pre-tax and post-tax contributions depending on employer design
4. Employer can control investment selection and decisions; can make investment option decisions with employee selecting allocation; or can leave all investment decisions to the employee.
5. Funds accumulate until withdrawn by the worker at job termination or retirement as they own the entire account (once vested – which can vary from immediate on worker contributions to up to 7 years on employer contributions)
6. Distribution options are determined by the employer with selection among options made by the worker

Why Defined Contribution Plan Shift in US

EMPLOYER

Workers understand them

Workers like them

Workers like their flexibility

Workers like their clarity

Employers like their fixed % cost

Employers like the shift of
investment risk to the worker

Employers like design choice
from all employee cost and all
employee voluntary to defaults to
requirements

WORKER

I watch contributions and growth

I can take the money with me

I can take a loan from the plan

What I see is what I get

Workers like the clarity

Workers like the upside potential

Workers just like the plan
with automatic payroll deduction

The Very Basic View of Regulation

- The voluntary plan must meet the requirements set out by the Internal Revenue Service for:
 - Participation
 - Vesting
 - Distributions
- The simplest plan for an employer is one that has a “safe harbor” if you make minimum contributions or matching contributions with immediate vesting (detail slide follows)
- The employer wants the most participation possible so that highly paid employees can participate and contribute
- The best way to get workers to contribute has been for the employer to default workers into the plan and to match a portion of the worker contribution

ADP SAFE HARBOR CONTRIBUTIONS

(No ADP Test Required/ACP Test May Not Be Required)

3% NONELECTIVE CONTRIBUTION (NEC)

No Allocation Requirements may be imposed, such as, a 1,000 hour or last-day requirement

100% Vested

Not available for in-service withdrawal before age 59½, even for hardship [An exception has been made in the past for plans in Hurricane designated areas as provided in the Katrina Emergency Tax Relief Act (KETRA) and Gulf Opportunity Zone Act (GOZA) from the date in 2005 until December 31, 2006. The same type of relief was passed as part of the Emergency Economic Stabilization Act (EESA) of 2008 for Midwestern Disaster Areas from 2008 until December 31, 2009.]

Can be used to satisfy top-heavy minimum contribution

Must be used in cross-testing gateway test, may be counted towards satisfying cross-testing.

Cannot be used to satisfy permitted disparity

Available in guaranteed or flexible formula:

a. Guaranteed provides required 3% (or more) each year

b. Flexible allows employer to decide each year on 3% or more

OR: MATCHING CONTRIBUTION A. OR B. BELOW

A. BASIC MATCH: 100% of first 3% deferred plus 50% of next 2% deferred

No Allocation Requirements may be imposed, such as, a 1,000 hour or last-day requirement

100% Vested

Not available for in-service withdrawal before age 59½, even for hardship (EESA exceptions apply)

Can be used to satisfy Top-Heavy minimum contribution

B. ENHANCED MATCH: Matching formula must be at least as generous as the basic formula

No Allocation Requirements may be imposed, such as, a 1,000 hour or last-day requirement

100% Vested

Not available for in-service withdrawal before age 59½, even for hardship (EESA exceptions apply)

Can be used to satisfy Top-Heavy minimum contribution

Rate of match may not increase as deferral percentage increases

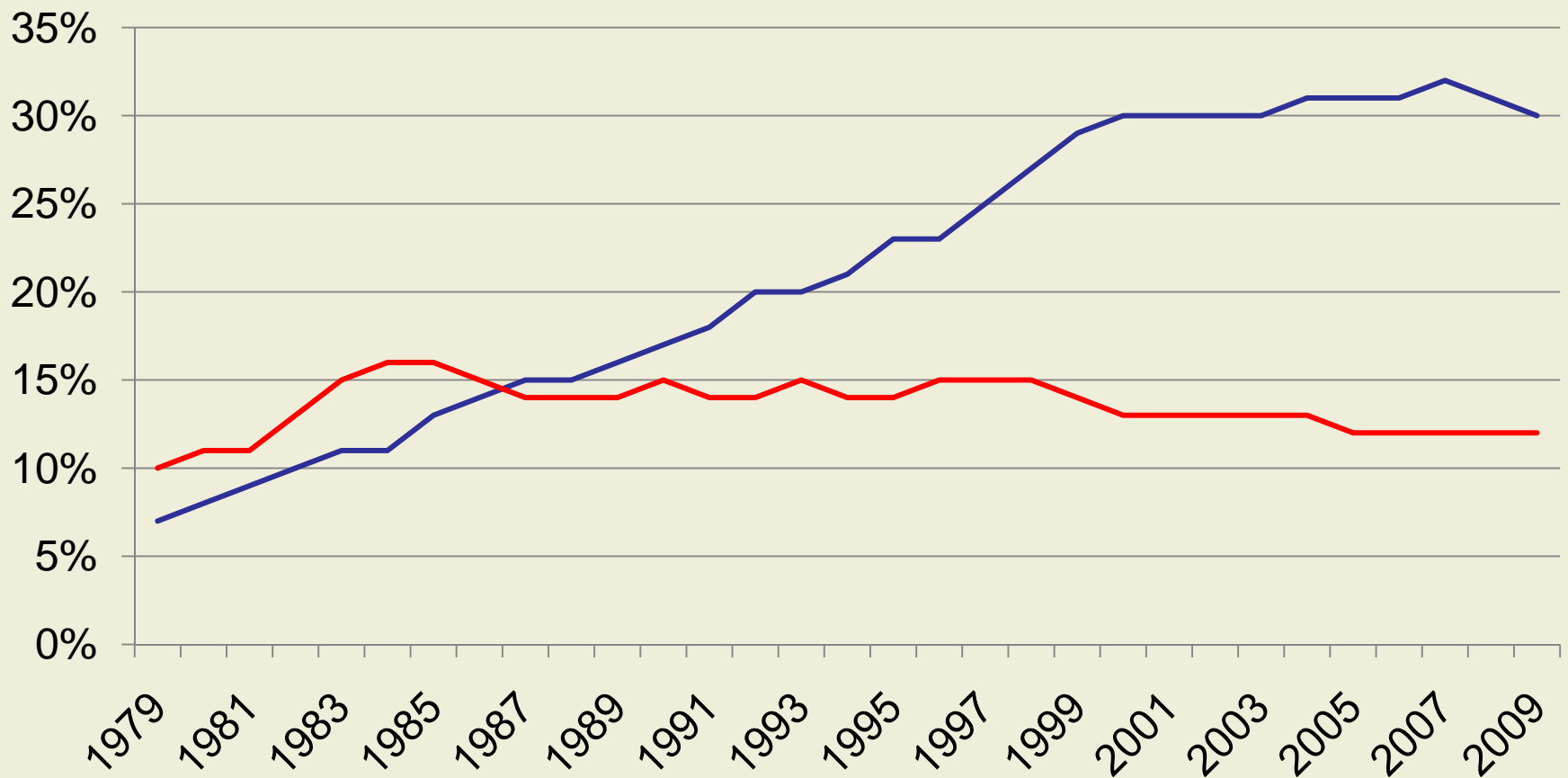
NOTE: The top-heavy minimum contribution may be waived on an annually determined basis for plans using either the safe harbor basic or enhanced matching formula, provided there is no allocation of any other employer contributions, including reallocation of forfeitures. Such a plan would actually be exempt from the top-heavy rules for the year

Source: SAFE HARBOR 401(K) CHART

Bill Grossman, QPA

05/16/03; Rev. 10/30/03; Rev. 12/29/05; Rev. 06/05/09; Rev. 06/20/09

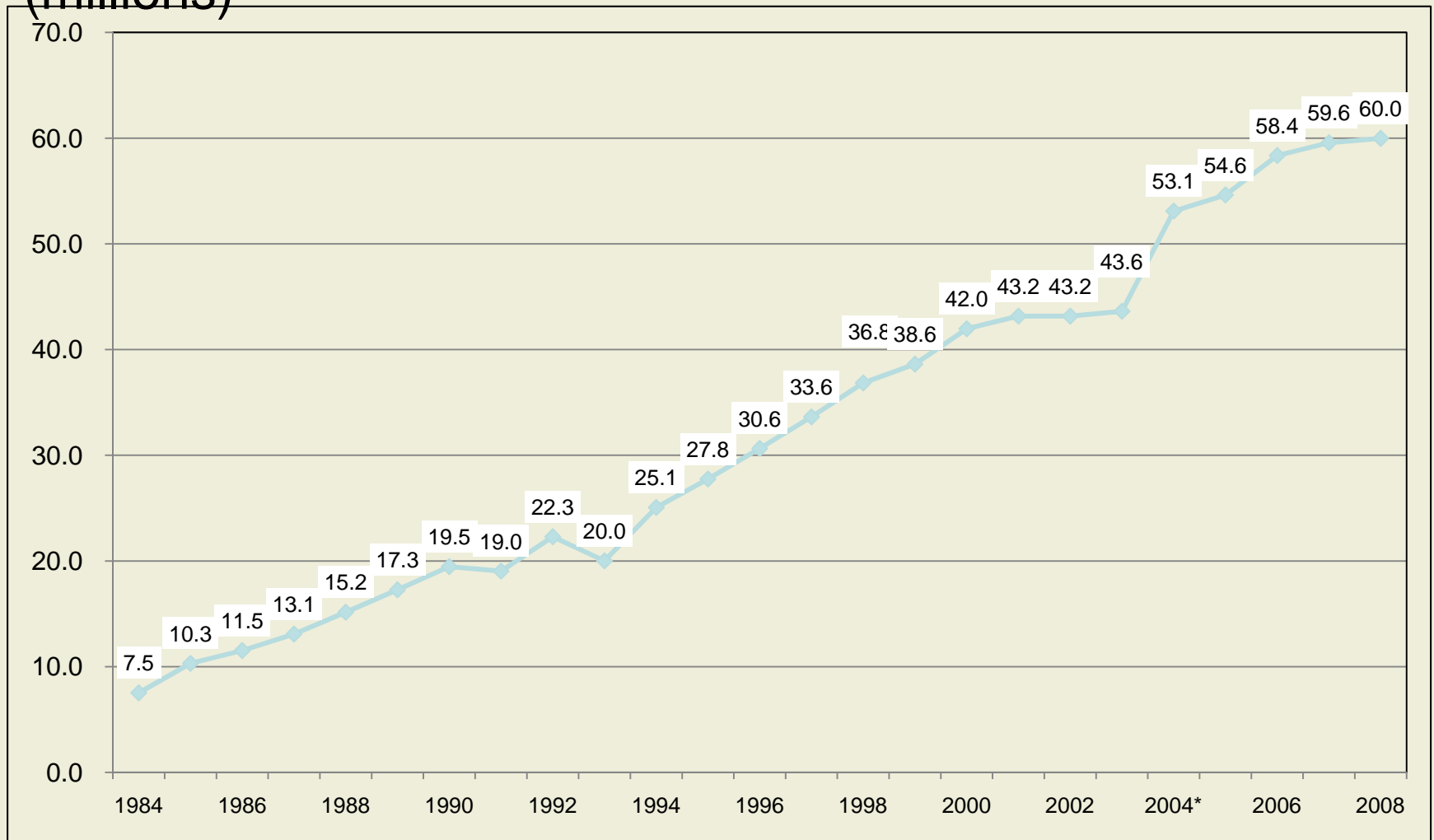
Percentage of Private Sector Workers Participating in an Employment-Based Retirement Plan by Plan Type, 1979-2009*



Source: DoL Form 5500 Summaries through 1998.

*EBRI estimates 1999-2009

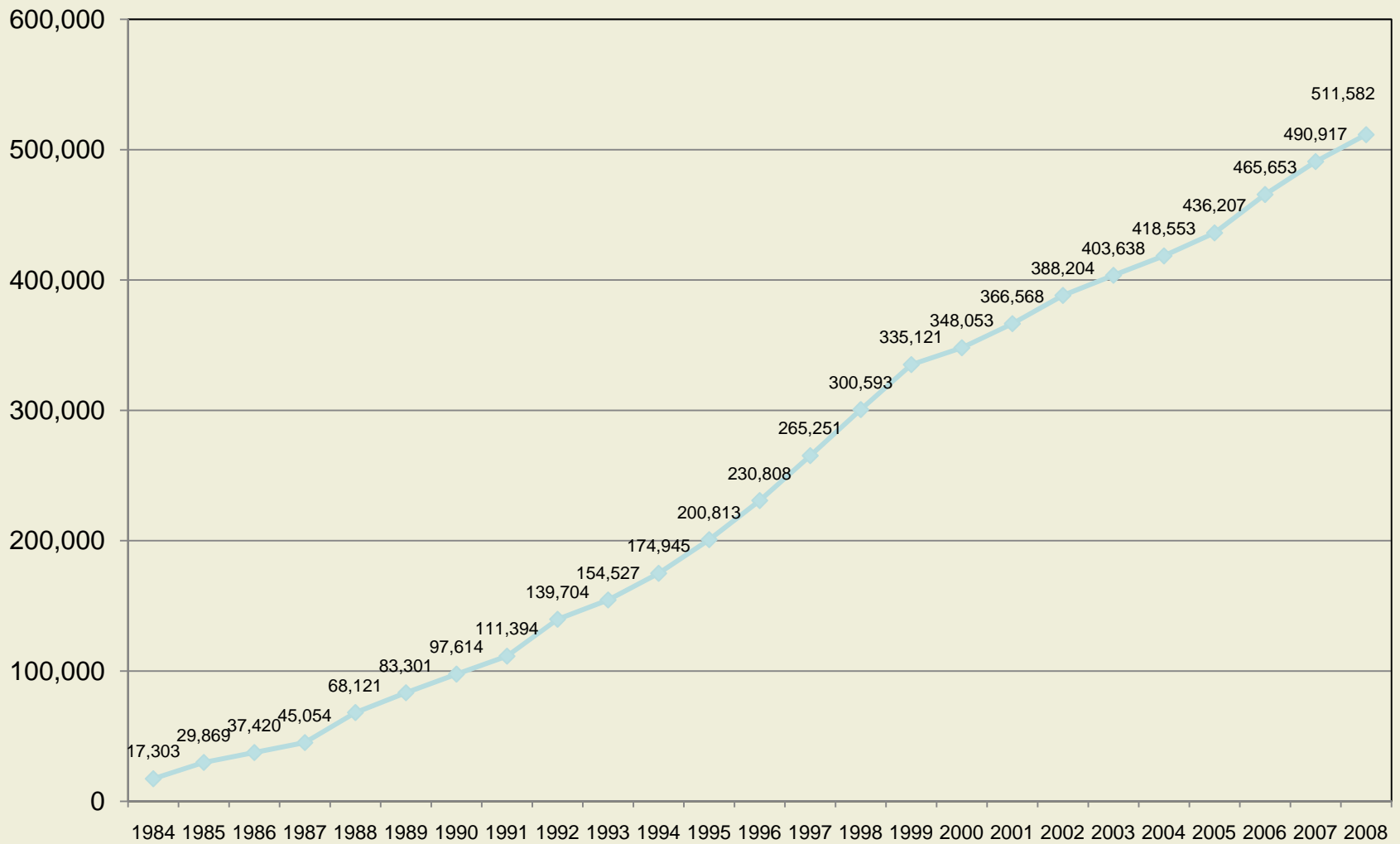
Active Participants in 401(k) Plans, 1984-2008 (millions)



Source: DoL Pension Plan Bulletin, Historical Tables, 1975-2008.

*In 2004, the DoL counted active participants differently causing a one year jump in the number of active participants.

Number of 401(k) Plans, 1984-2008



Source: DoL Pension Plan Bulletin, Historical Tables, 1975-2008.

2. The way in which matching contributions are used in the system

Table 5
DISTRIBUTION OF PARTICIPANTS BY PLAN MATCH LEVEL AND PLAN MATCH RATE,^a 1999
 (Percentage of Participants)

		Match Rate ^b							Total
		\$0.25	\$0.33	\$0.50	\$0.67	\$0.75	\$1.00	Other	
Match Level ^c	2%	0%	0%	2%	0%	0%	3%	2%	8%
	3%	4	1	1	0	0	5	1	12
	4%	1	0	4	0	1	2	2	9
	5%	1	0	1	0	2	5	5	13
	6%	2	4	27	5	3	4	5	49
	7%	0	0	4	0	0	0	0	5
	8%	0	0	1	0	0	0	0	2
	9% or more	0	0	1	0	0	0	1	2
	Total	8	5	41	5	6	20	15	100

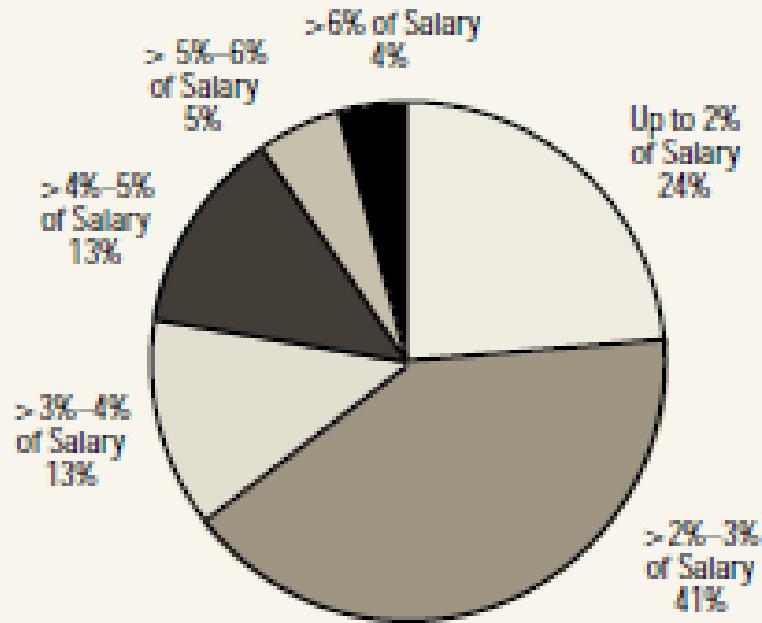
Source: Tabulations From the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

^aSample of nearly 1 million participants for whom employer matching contribution information was provided or derived.

^bMatch rate is the percentage of each dollar contributed by the employee for which the employer makes a matching contribution (shown as cents on the dollar).

^cMatch level is the percentage of salary up to which employee contributions will be matched by the employer.

Chart 7
**DISTRIBUTION OF EFFECTIVE MATCH RATES^a
 AMONG PLANS OFFERING MATCHING EMPLOYER
 CONTRIBUTIONS,^b 1999**
 (Percentage of Participants)



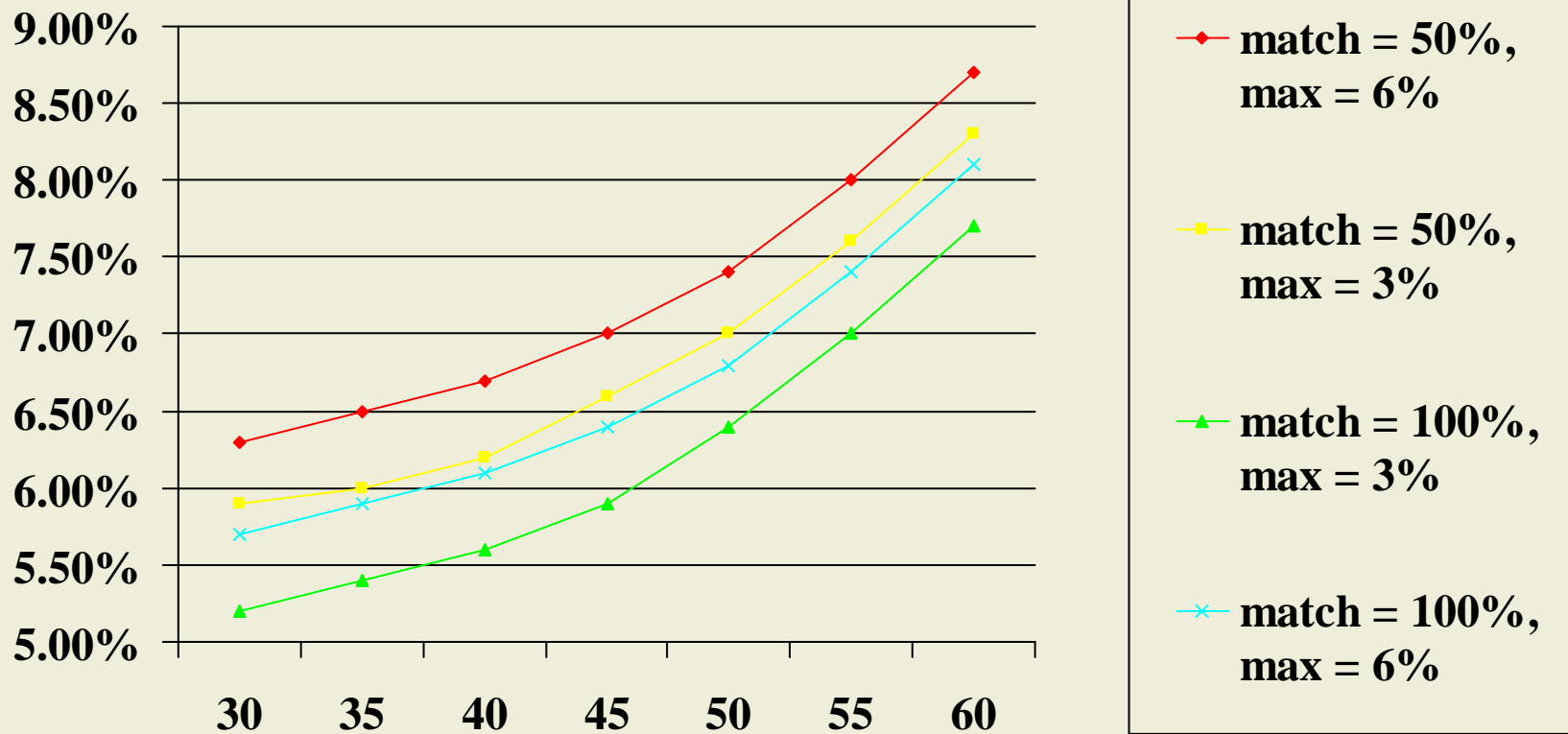
Source: Tabulations From the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

^a The effective match rate is the match level multiplied by the match rate.

^b Sample of nearly 1 million participants for whom employer matching contribution information was provided or derived.

3. Overall patterns of coverage and the impact of matching contributions on participation (plus auto enroll, etc.)

Employee contributions for men by age as a percentage of annual compensation for various combinations of initial match rate and maximum amount of compensation matched



2005 RCS results (see first row)

Figure 6

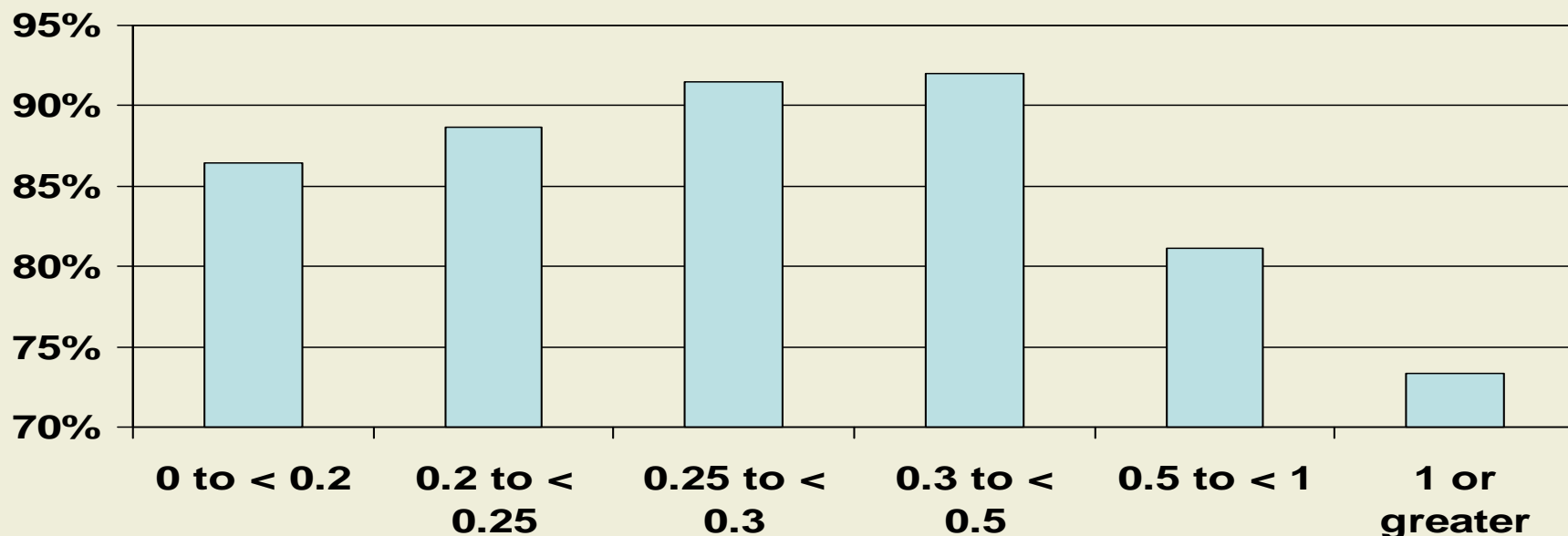
Change in Likelihood of Participating in Savings Plan if Feature Were Offered, Among Workers Offered Employer-Sponsored Plan But Not Participating

	Much More Likely	Somewhat More Likely	No More Likely	Already Offered
A matching contribution of up to 5% of your salary	31%	41%	14%	13%
A fund option that is designed for people of your age and income level and automatically becomes more conservative as your retirement date nears	21	44	29	5
An option that automatically raises your contribution by a certain percentage or amount whenever you receive a pay raise	19	37	37	7
A matching contribution of up to 3% of your salary	16	35	35	14
An option where a professional financial manager makes investment decisions for you based on your responses to a questionnaire	15	20	49	14
A fund option that maintains a pre-set level of risk and generally has a mix of conservative, moderate, and aggressive investments	13	36	32	19

Source: Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2005 Retirement Confidence Survey.

4. The effect of employers dropping matching contributions during the recent recession

Impact of suspending employer contributions: Percentage of 401(k) participants continuing to contribute in 2008 after a suspension in employer contributions by match rate proxy

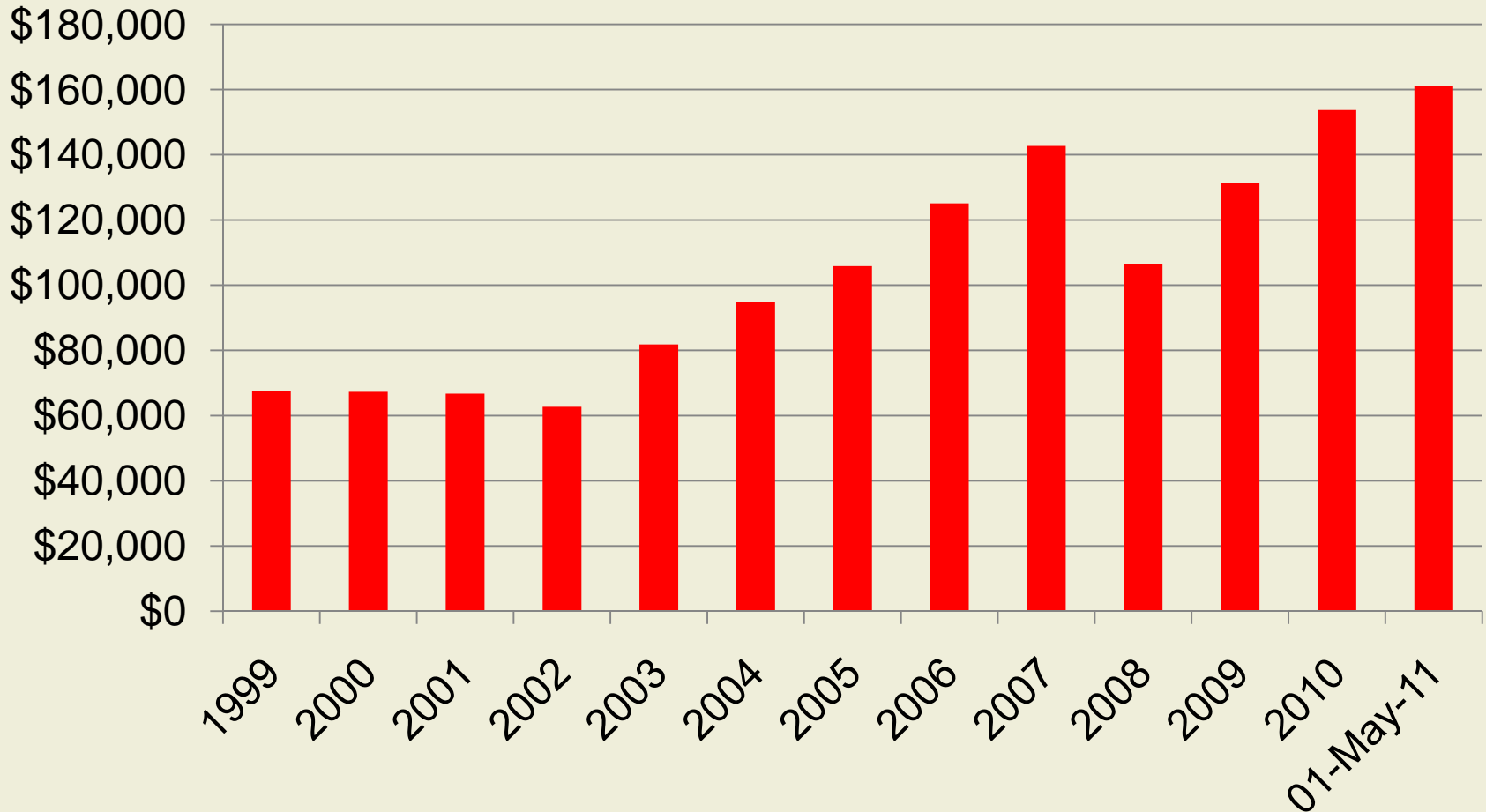


Plan aggregate employer contributions/employee contributions for 2007

Note: tabulations from 401(k) plans with more than \$100,000 in employer contributions in 2007 and none in 2008.

5. Account balances now relative to before the recession

401(k) Account Balances^a Among 401(k) Participants Present From Year-End 1999 Through Year-End 2009 With Projections Through May 1, 2011^b

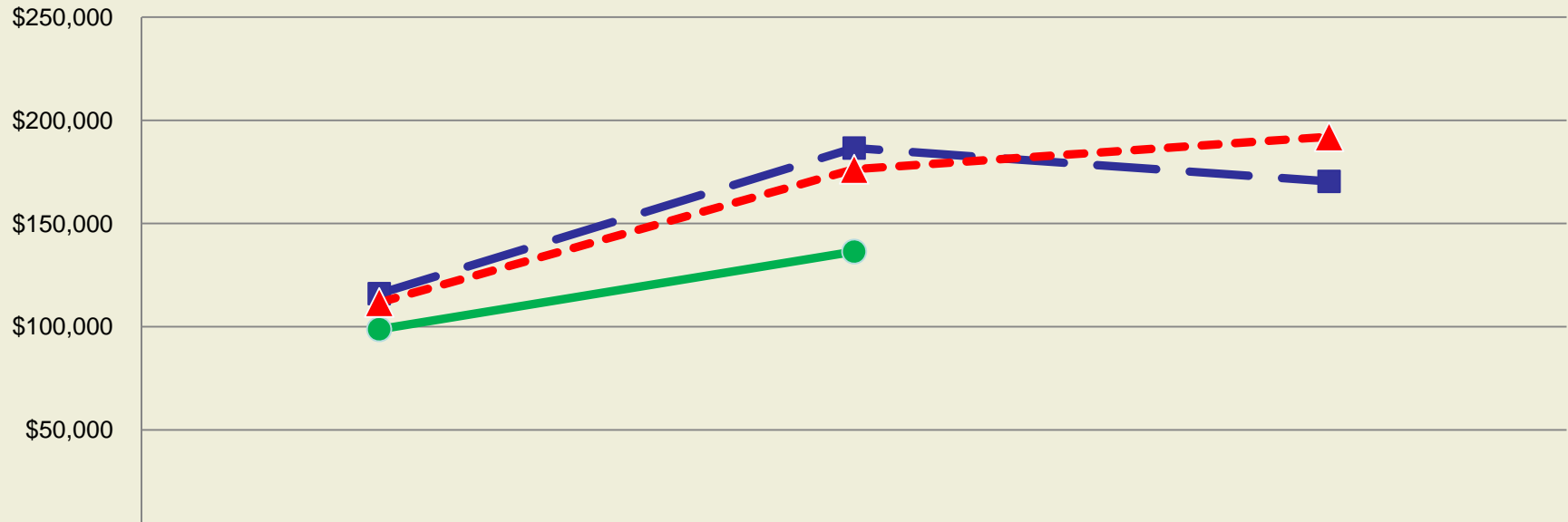


Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

^a Account balances are participant account balances held in 401(k) plans at the participants' current employers and are net of plan loans. Retirement savings held in plans at previous employers or rolled over into IRAs are not included.

^b The analysis for 1999 through 2009 is based on a group of 1.6 million participants with account balances at the end of each year from 1999 through 2009. The values for 2010 and May 1, 2011 are EBRI estimates

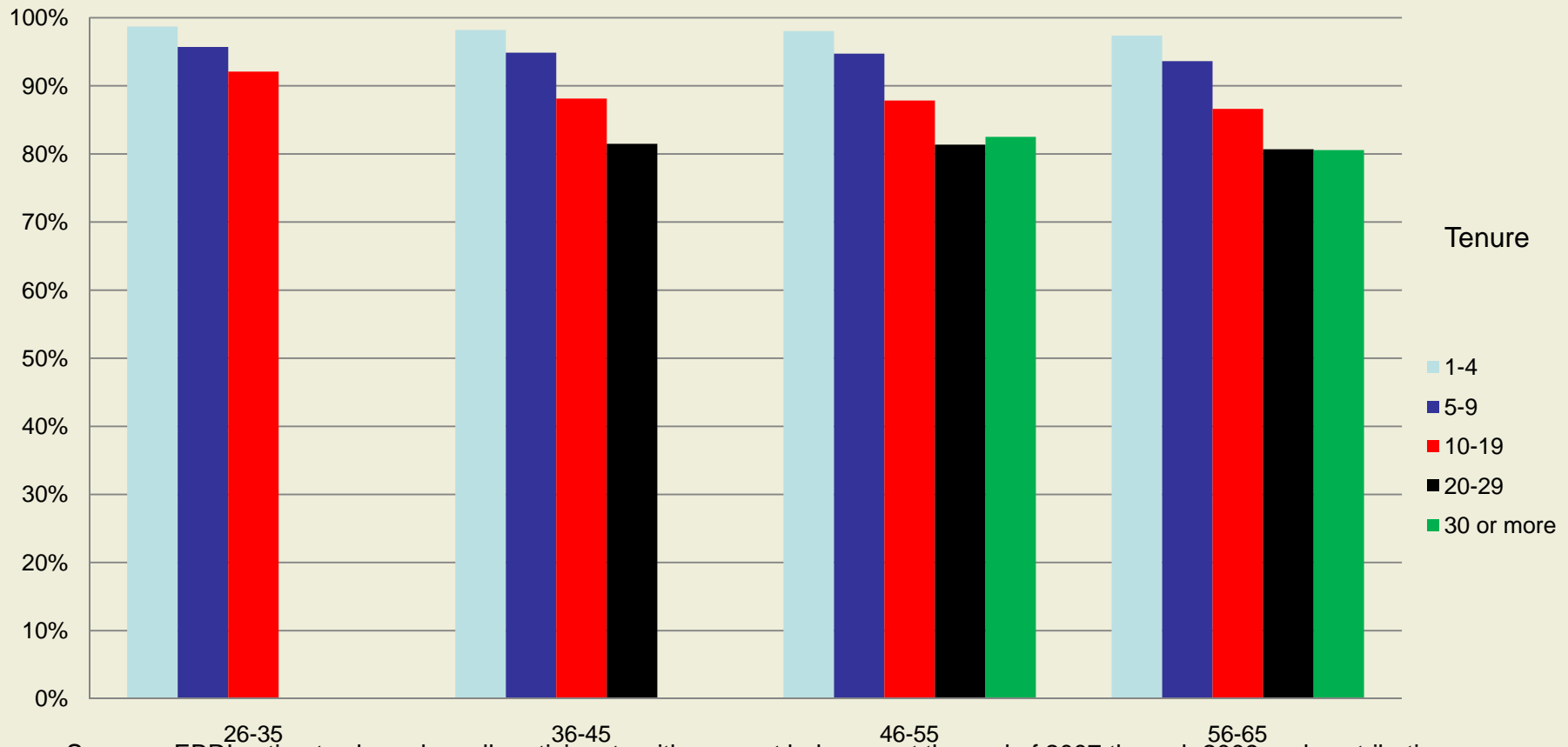
Figure 3: Average Account Balances Among 401(k) Participants Present From Year-End 1999 Through Year-End 2009, by Age and Tenure



	>10–20	>20–30	>30
—●— 40s	\$98,743	\$136,379	
—■— 50s	\$116,009	\$186,580	\$170,384
—▲— 60s	\$111,689	\$176,281	\$192,032

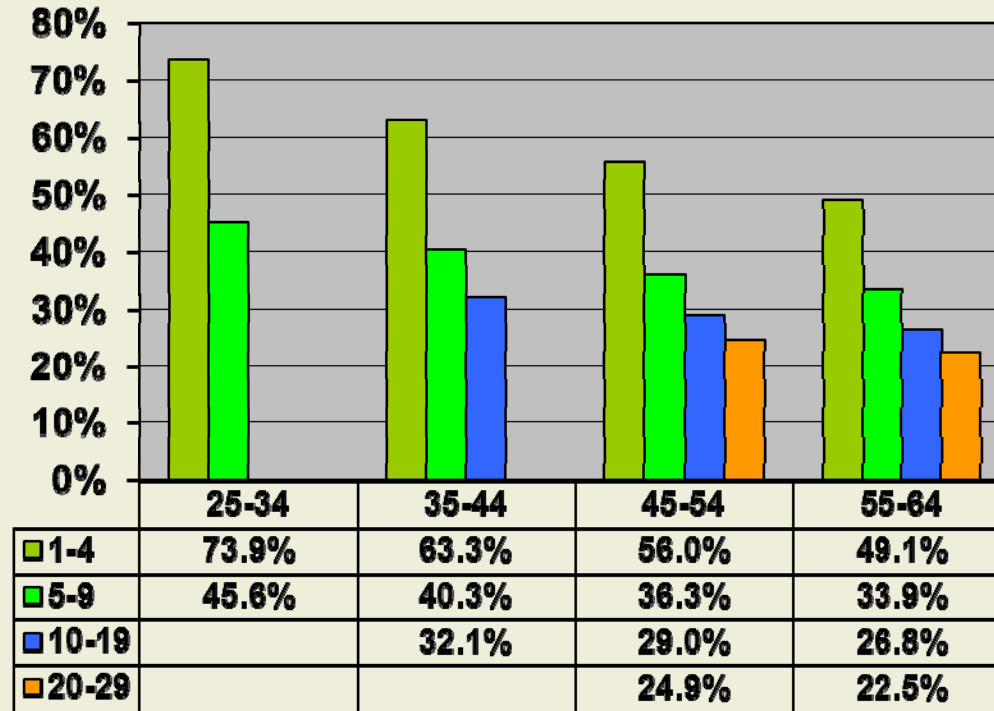
Source: Tabulations from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project. The analysis is based on a group of 1.6 million participants with account balances at the end of each year from 1999 through 2009. Age and tenure groups are based on participant age and tenure at year-end 2009.

Figure 4
Percentage of participants who have more money in their 401(k) accounts on June 1, 2011 than at the market peak in October 2007, by age and tenure



Sources: EBRI estimates based on all participants with account balances at the end of 2007 through 2009 and contribution information for those years.

Figure 2: Change In Average Account Balances (by Age and Tenure) From January 1, 2010 – June 1, 2011 Among 401(k) Participants with Account Balances as of Dec. 31, 2009

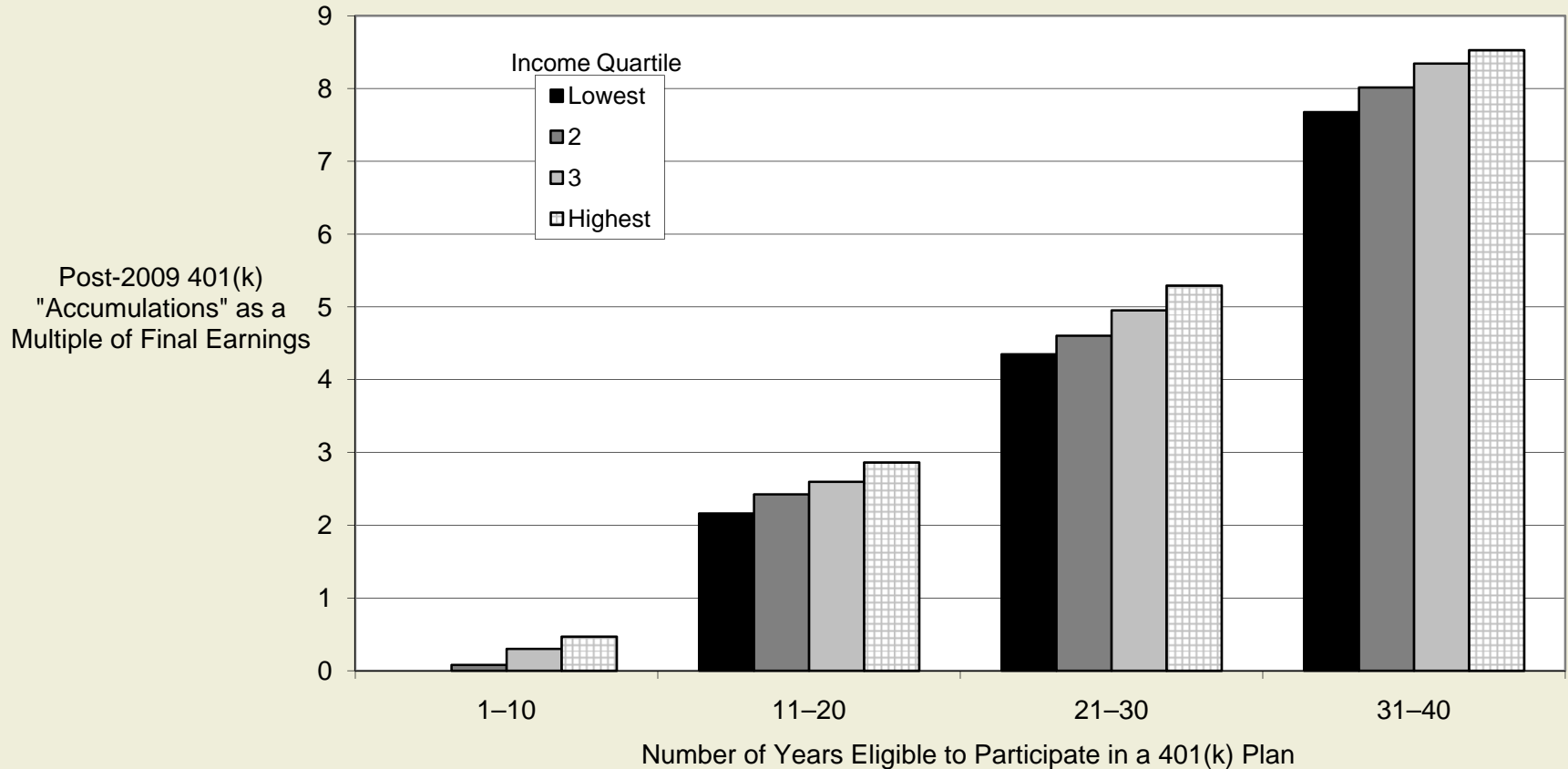


Sources: 2009 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2011 Account Balances: EBRI estimates. The analysis is based on all participants with account balances at the end of 2009 and contribution information for that year.

6. What could they deliver in the future – depending upon workforce factors: voluntary enrollment vs. automatic enrollment

Figure 8

**Employees Currently Ages 25–29:
Median 401(k) Accumulation Multiples for Auto-Enrollment With 2009 Plan Formulae
as a Function of Salary Quartile and Number of Years Eligible for a 401(k) Plan**



Source: Source: EBRI/ERF Retirement Security Projection Model,® version 100205a4 . See text for explanations of models and assumptions.

7. Reform and the future

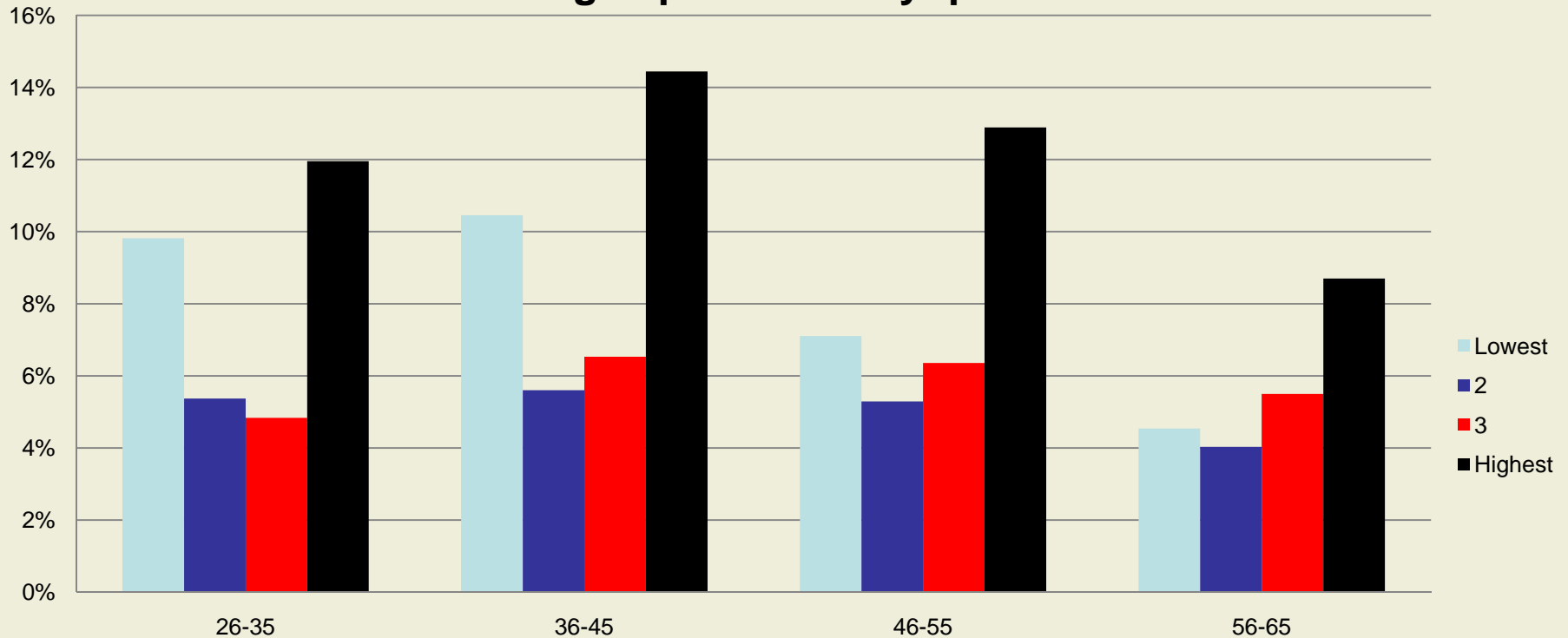
Design flexibility has been the primary reason for DC system growth – allowing extremes of voluntary participation worker only contribution plans will full access to funds to base employer contribution to get 100% participation then generous match to with auto escalation of contributions, funds access only on job change or retirement, and in plan life income options.

In other words, a range from simple tax favored worker savings to employer financed retirement income.

Reformers would like mandatory sponsorship, mandatory participation, mandatory contributions, guaranteed minimum returns, no funds access prior to retirement, and life income distributions that increase with inflation.

In other words, a mandatory defined contribution program with life income.

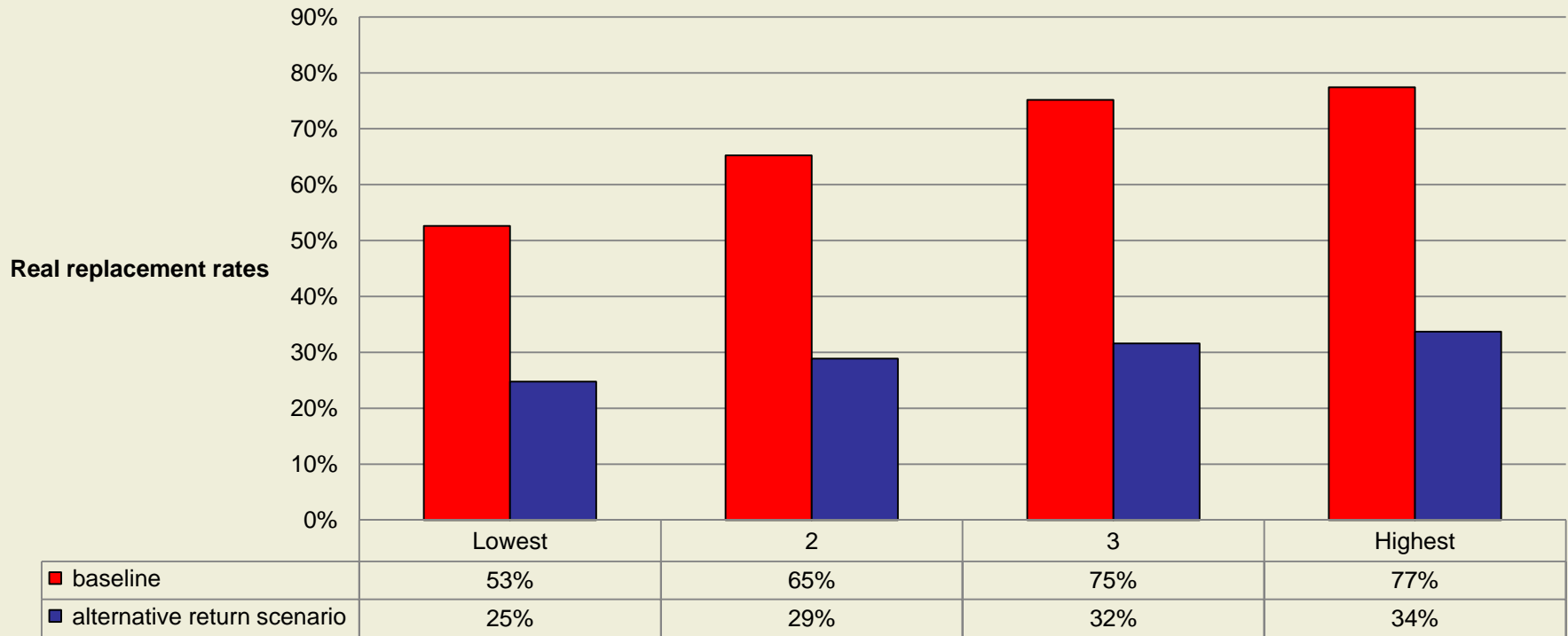
Figure 6
Average percent reductions in 401(k) account balances at Social Security NRA by imposing 20/20 limits in 2012, by age and age-specific salary quartiles



Source: EBRI Retirement Security Projection Model Version 110503c1.

NB: this simulation only models the financial impact of the expected reduction in 401(k) contributions for employees who are not automatically enrolled by imposing the new limits and does not attempt to assess behavioral modifications on the part of either the plan sponsor nor the employees assumed to be eligible for participation in the plan. The simulated rates of return are the same as in VanDerhei and Copeland (July

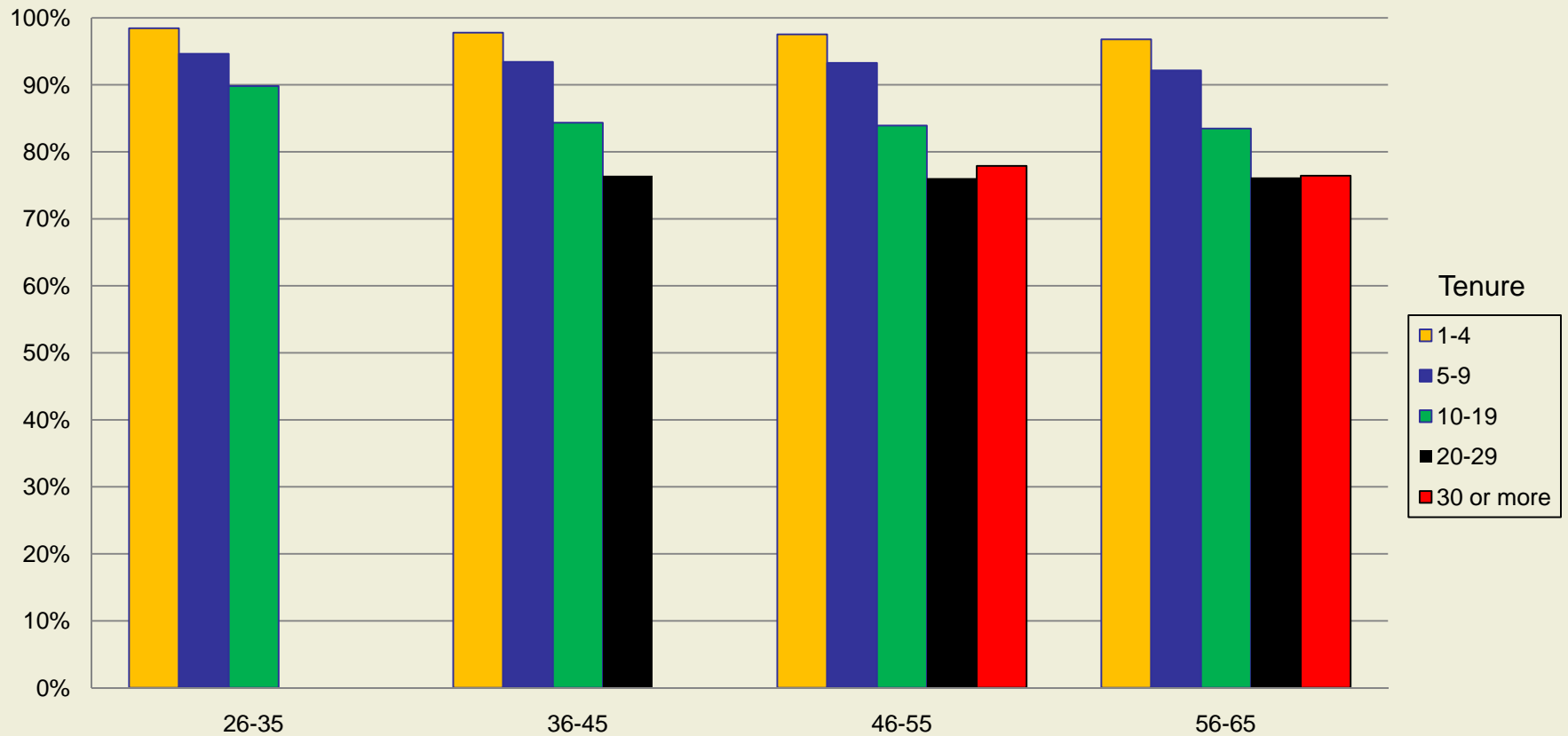
Figure 5
Median real replacement rates at age 67 from 401(k) balances
for participants currently ages 25-29 by income quartile



Source: EBRI Retirement Security Projection Model Version 110503c.

The simulated rates of return for the baseline and alternative return scenario are the same as in VanDerhei and Copeland (July 2010). This version of the analysis models 401(k) participants who are not automatically enrolled and assumes no job turnover, withdrawals or loan defaults. The full stochastic nature of the model will be included in future analysis.

Percentage of participants who have more money in their 401(k) accounts on March 1, 2011 than at the market peak in October 2007, by age and tenure



Sources: EBRI estimates based on all participants with account balances at the end of 2007 through 2009 and contribution information for those years.

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