

# The Next Frontier in 401(k) Plan Management

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**New England Employee Benefits Council**  
Benefits Club Breakfast  
Bentley College

**Contact Info:**

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# Introduction

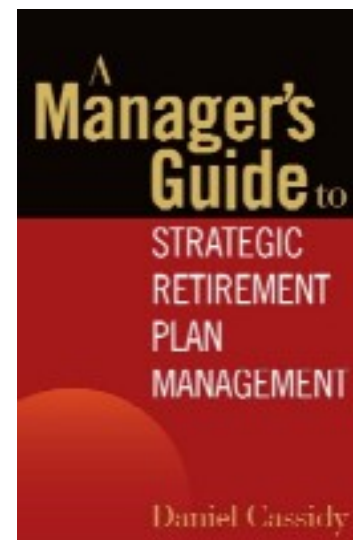
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## □ Cassidy Retirement Group

- Independent, fee-for-service retirement consulting firm
- Registered with the SEC as an investment advisor
- Clients primarily throughout New England
- Provide assistance on 401(k) and DB plans including fiduciary benchmarking, investment performance reviews

## □ Dan Cassidy

- ~20 Years of benefits consulting
- Actuary (FSA), Chartered Financial Analyst (CFA)



# Agenda

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- Where we're at
- Mutual Fund Challenges
- Participant Risks in Retirement
- What's next

# Where we're at

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- Employer
  - Auto-enrollment
  - Auto-escalation of contribution levels
- Investments
  - Default fund to age-based retirement funds
- Plan Provisions
  - Modifying match to comply with safe-harbor provisions
  - Additional base level of contributions (tied to auto-enrollment?)

# Where we're at

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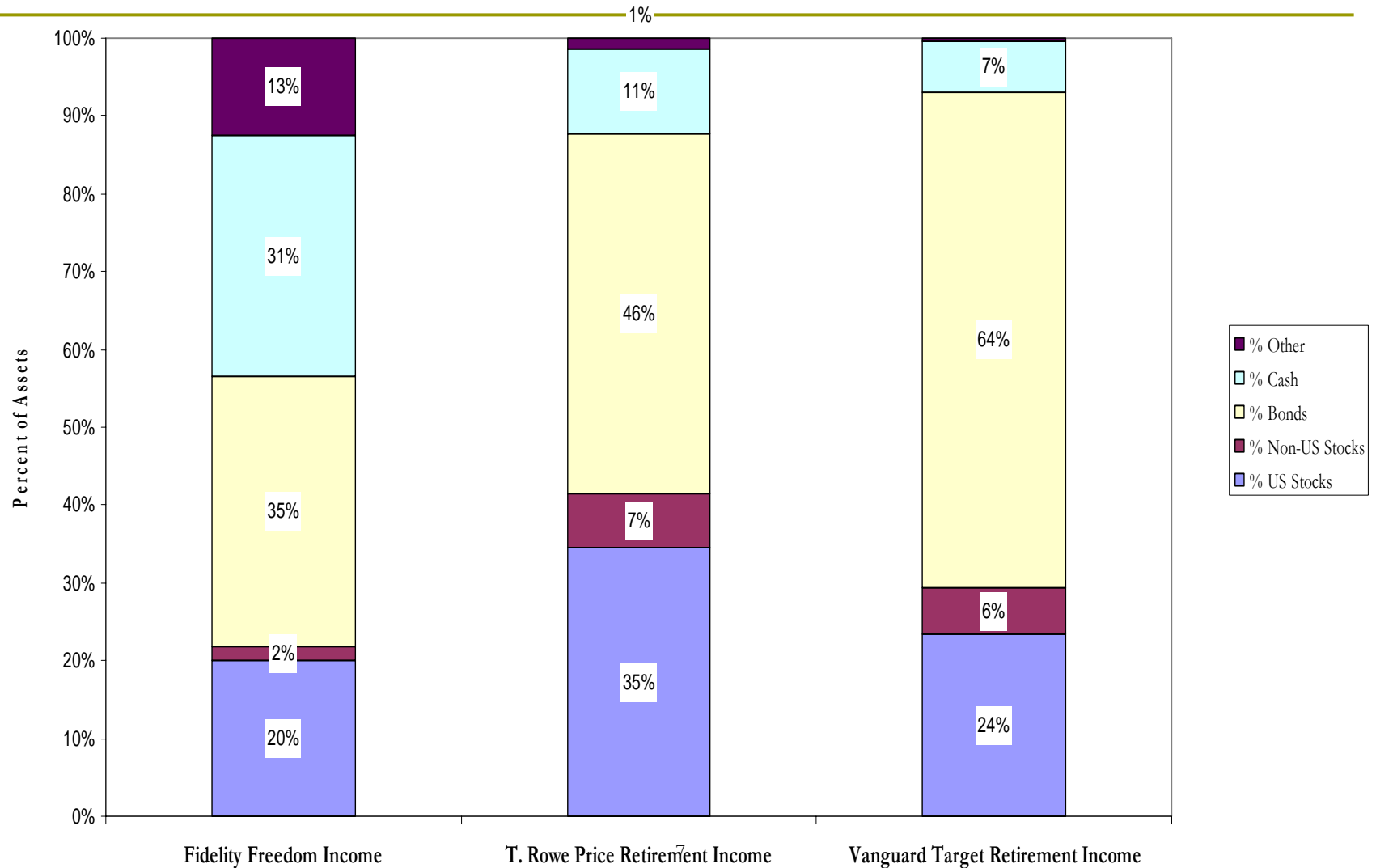
- Average Account Balance
  - For participants in 60's = \$160,000
- Distribution
  - About 30% take lump sum payments

# Mutual Funds - Challenges

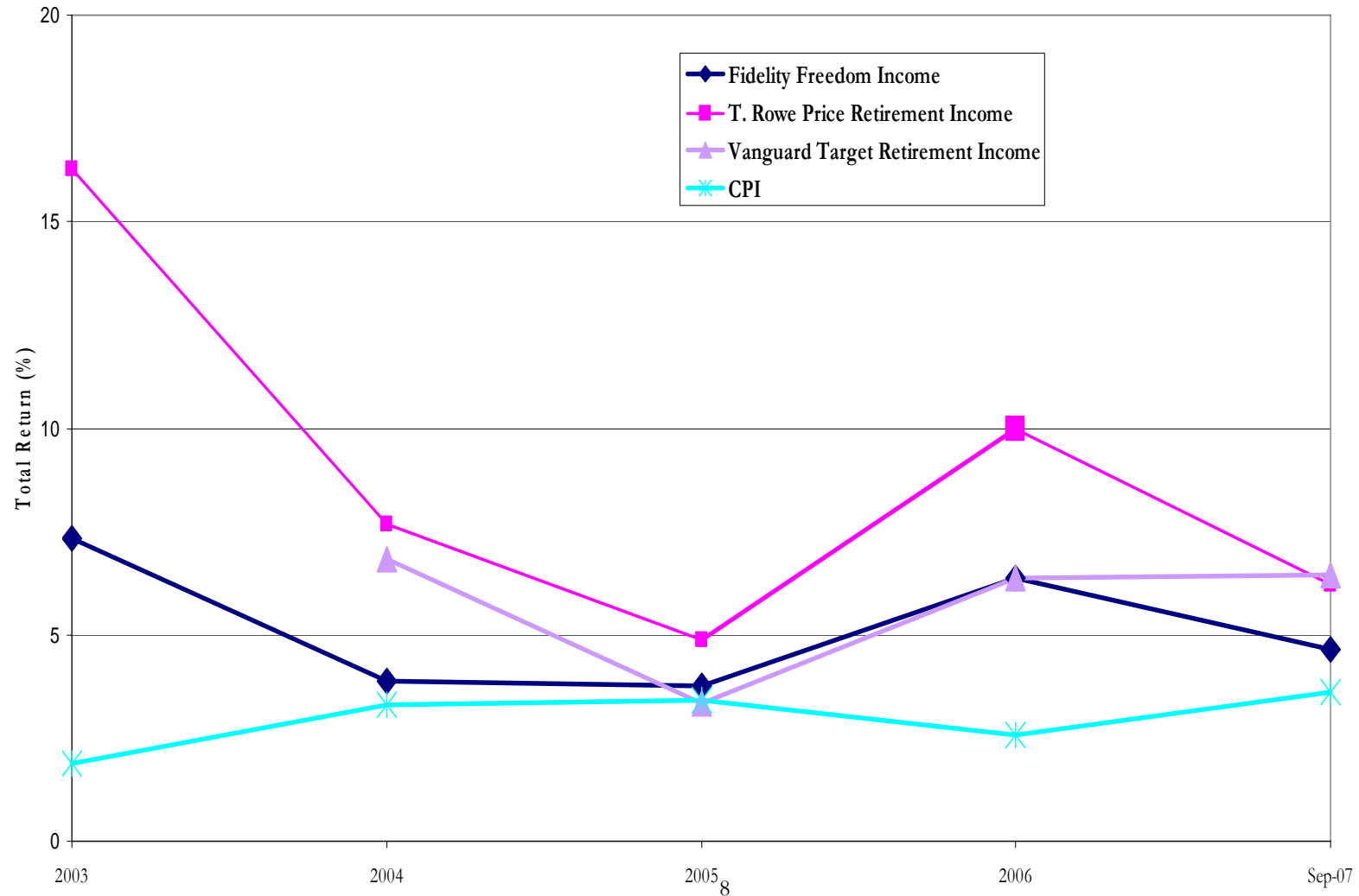
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- Retail versus institutional
  - Expense levels
    - Trend – Growth of separate accounts (moving to mid-market)
- Group versus individual
  - Inability to self-annuitize – mutual fund pool
- Risky models in current age-based options
  - High Equity Exposure
    - Fallacy long term horizon - example equity put option
  - Tax efficiency with Capital Gain Tax < Income Tax
    - Where to take risk – inside or outside qualified plan
  - Compare to defined benefit – liability driven investing (LDI)

# Asset Allocation – In pay status



# Correlated Returns with Inflation?



# Risks Participants Face

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## □ Primary Post-Retirement Risks

### ■ Longevity

- Both Participant and Spouse

### ■ Inflation

- Retirees face higher inflation than others

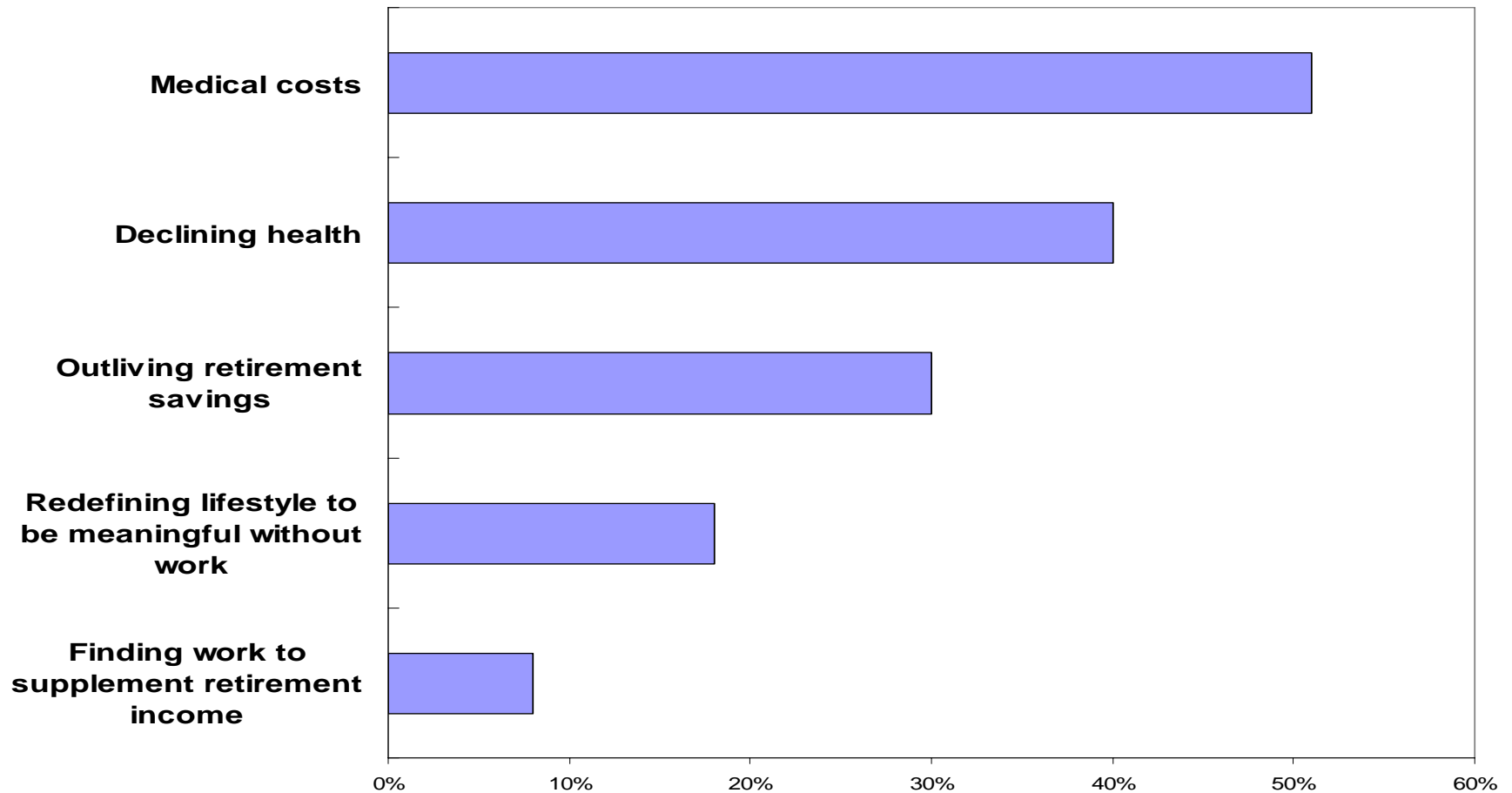
- CPI-E (experimental CPI for consumers over age 62) higher than CPI-U

### ■ Medical

- Long term care

# Employees' Top Concerns

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Source: Towers Perrin, Back to the Future: Redefining Retirement in the 21<sup>st</sup> Century

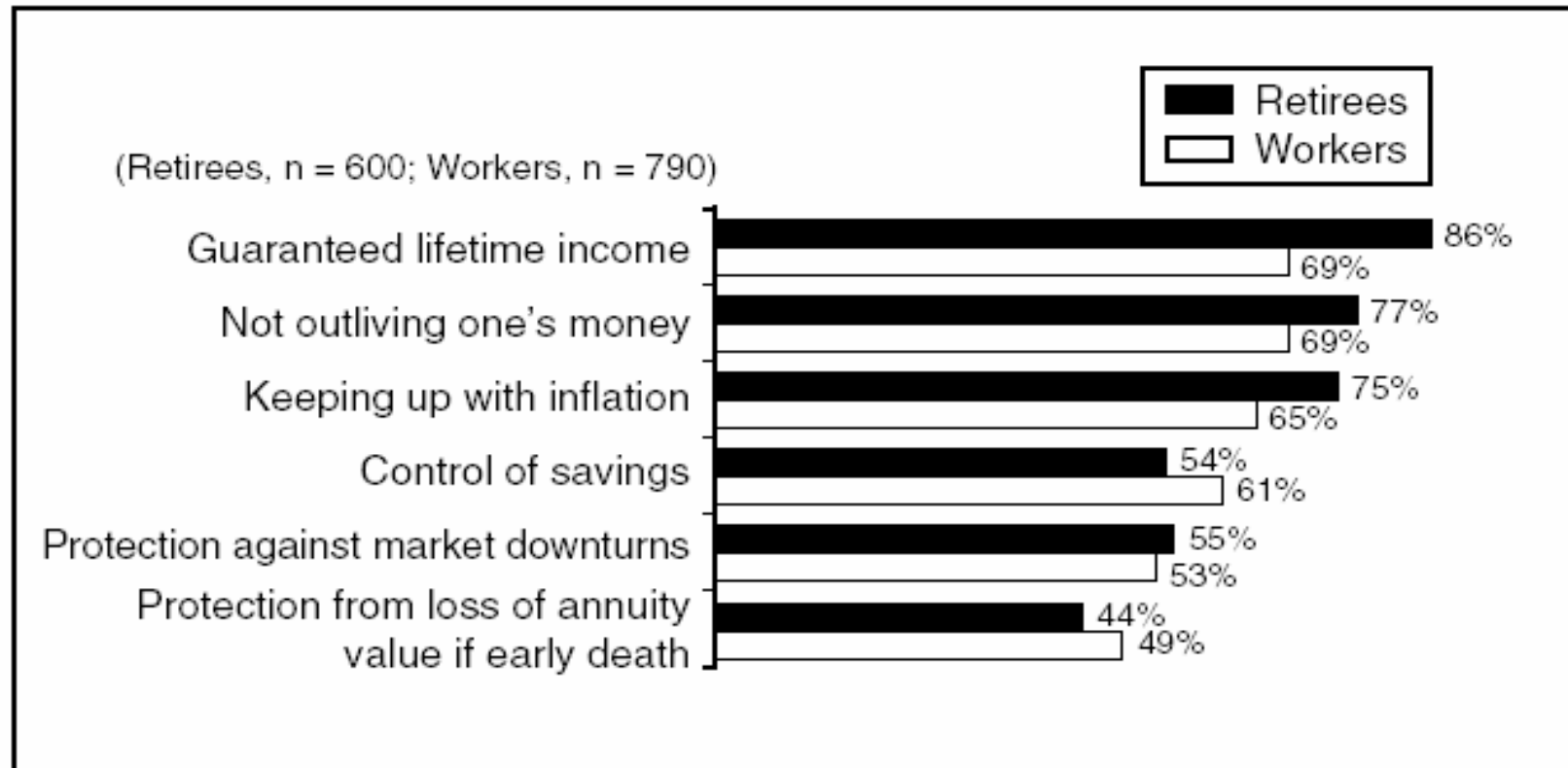
# Differences in Generations

## Expected Sources of Retirement Income (in order of Importance)

All Employees	Age 18 – 34	Age 35 – 49	Age 50 – 59
401(k)/403(b)	401(k)/403(b)	401(k)/403(b)	<b>Social Security</b>
Social Security	<b>Personal Savings</b>	<b>Social Security</b>	401(k)/403(b)
Personal Savings	<b>Social Security</b>	<b>Personal Savings</b>	Company Pension
Company Pension	Company Pension	Company Pension	<b>Personal Savings</b>
Part-Time employment during retirement	Part-Time employment during retirement	Part-Time employment during retirement	Part-Time employment during retirement

# Preference in Distribution

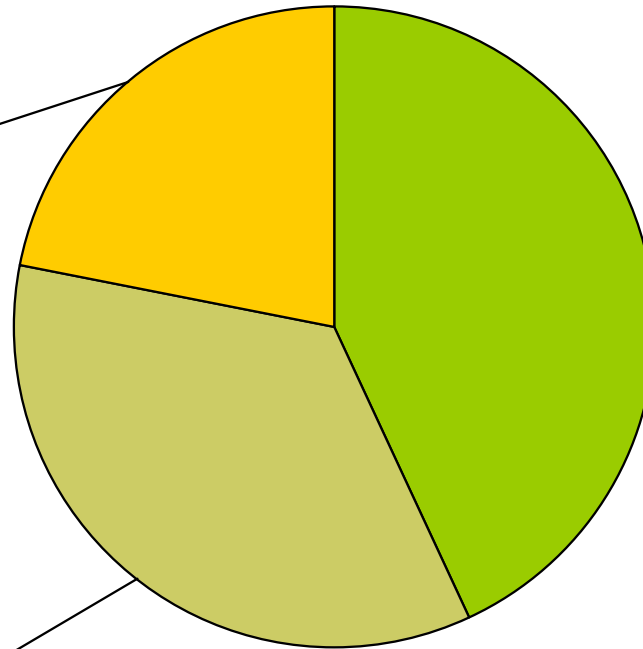
When deciding on what payment option to choose from your retirement plan, how important are each of the following? (percentage saying *very* important)



# Working in Retirement

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**Will retire as early as possible, and will NOT seek other for-profit work, 22%**



**Continue to work to stay involved and active, but NOT for financial needs, 43%**

**Continue to work for financial reasons, 35%**

Source: Towers Perrin, Back to the Future: Redefining Retirement in the 21st Century

# Retirement Plan Reality

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- Who is the focus?
  - Not the rich
    - Sufficient assets, access, advice to manage retirement years
  - Not the poor
    - No hope of accumulated sufficient assets – working poor
  - Middle class
    - Primary focus of employment-based retirement programs
    - Estate tax not issue (\$2 million exclusion)

# Today's Financial Planning

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- ❑ Focus on mutual fund environment (in plan or outside of plan in IRA)
- ❑ Limit annual withdrawals
  - Many advisors, financial calculators cite 4%
- ❑ Focus on asset allocation
  - Decrease equity exposure while increasing fixed income exposure
- ❑ Problems
  - Not focused on risks (either inflation or longevity)
  - Cost
  - Requires ongoing management
  - Maintains exposure to capital markets

# New Offerings

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- Guaranteed Options
  - Annuity Purchases
  - More “planned” options
    - “Mutual” Fund with planned withdrawal schemes
- Disability coverage – pre-retirement
- Combination insurance products
  - Annuity combined with long-term care

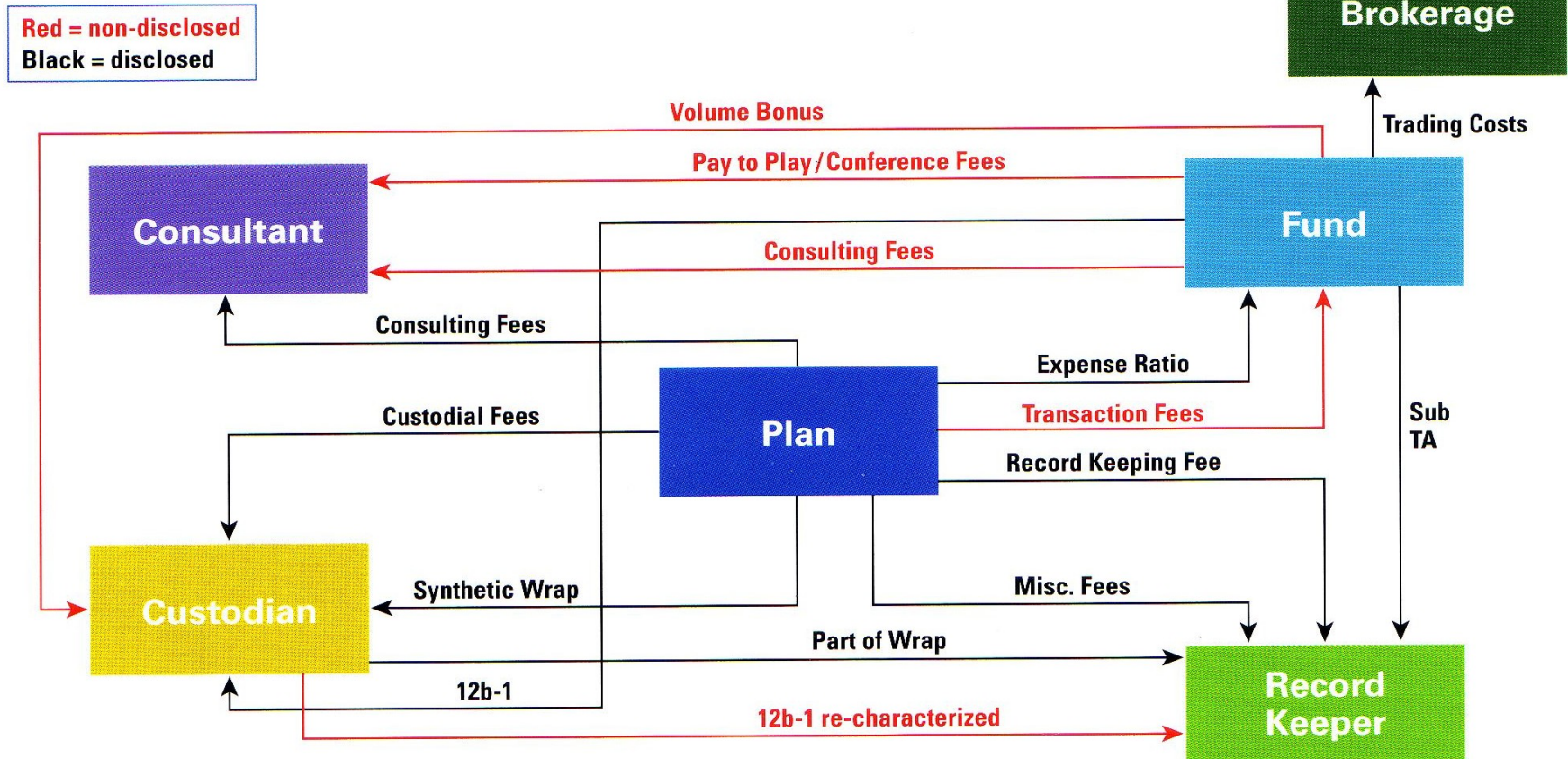
# Concerns

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- Who to trust?
- What's guaranteed?
- What will work?
- Redefining ROI
  - from Return on Investments to Reliability of Income)
- Fees
  - How much do these investments cost my participants?
  - Who is paid?

# Fees – Unbundled with Consultant

## Money Flows: Un-Bundled Provider With Consultant



Note: Not all flows apply to every case

# Sources and References

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- ❑ Employee Benefit Research Institute (EBRI) – Issue Brief No. 308 August 2007
- ❑ The Aon Consulting/Georgia State University 2004 Retirement Income Replacement Ratio Study
- ❑ Vanguard Center for Retirement Research “How America Saves 2007”
- ❑ Fidelity “Building Futures” series – VIII just published Nov 2007
- ❑ Society of Actuaries – various Retirement Risks material

# AON/Georgia State Replacement Ratio

## Key Findings

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### 2004 Replacement Ratio Findings

Pre-Retirement Income (\$000)	Replacement Ratios		
	Social Security (%)	Private and Employer Sources (%)	Total (%)
\$20	65	24	89
30	56	28	84
40	51	29	80
50	48	29	77
60	43	32	75
70	39	37	76
80	35	42	77
90	33	45	78

# EBRI Average Account Balance

**Figure 7**  
**Average Account Balances Among 401(k) Participants Present**  
**From Year-End 1999 Through Year-End 2006,<sup>a</sup> by Age and Tenure,<sup>b</sup> 1999–2006**

Age Group	Tenure (years)	1999	2000	2001	2002	2003	2004	2005	2006
20s	All	\$2,558	\$4,988	\$7,282	\$8,754	\$13,950	\$18,236	\$22,236	\$28,248
	5–10	\$2,147	\$4,480	\$6,817	\$8,371	\$13,568	\$18,037	\$22,158	\$28,095
30s	All	\$17,277	\$19,918	\$22,382	\$22,549	\$33,503	\$42,082	\$49,550	\$61,368
	5–10	\$9,086	\$12,760	\$16,232	\$17,757	\$27,856	\$36,263	\$43,995	\$55,453
	10–20	\$24,913	\$26,607	\$28,160	\$27,065	\$38,874	\$47,625	\$54,851	\$67,002
40s	All	\$50,147	\$51,423	\$51,908	\$48,599	\$66,490	\$79,588	\$90,149	\$108,262
	5–10	\$17,316	\$21,627	\$25,262	\$26,346	\$39,369	\$50,070	\$59,772	\$74,075
	10–20	\$49,613	\$50,574	\$50,886	\$47,258	\$64,809	\$77,563	\$87,805	\$105,501
	20–30	\$81,560	\$80,805	\$78,823	\$72,177	\$95,491	\$111,677	\$123,814	\$146,489
50s	All	\$82,059	\$82,495	\$81,350	\$75,546	\$98,811	\$115,006	\$127,058	\$148,927
	5–10	\$19,954	\$24,769	\$28,524	\$29,847	\$43,300	\$54,770	\$65,248	\$80,465
	10–20	\$57,100	\$59,067	\$60,185	\$56,282	\$75,237	\$89,738	\$101,585	\$121,160
	20–30	\$114,985	\$113,703	\$109,896	\$100,760	\$130,294	\$150,121	\$164,487	\$192,003
	30+	\$114,259	\$111,939	\$108,020	\$99,431	\$126,869	\$143,508	\$153,484	\$174,992
60s	All	\$121,982	\$118,088	\$113,375	\$103,711	\$127,008	\$139,140	\$144,269	\$157,727
	5–10	\$21,406	\$26,393	\$30,301	\$31,679	\$44,519	\$55,390	\$64,324	\$76,690
	10–20	\$62,602	\$65,309	\$65,892	\$62,437	\$80,718	\$94,030	\$103,616	\$117,934
	20–30	\$130,165	\$127,834	\$123,572	\$113,670	\$140,334	\$155,348	\$162,473	\$178,253
	30+	\$181,395	\$170,237	\$159,753	\$143,459	\$170,971	\$181,269	\$181,621	\$193,701
All	All	\$67,760	\$67,956	\$67,258	\$62,585	\$81,665	\$94,568	\$103,952	\$121,202

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

<sup>a</sup> The analysis is based on a sample of 3.0 million participants with account balances at the end of each year from 1999 through 2006.

<sup>b</sup> Age and tenure groups are based on participant age and tenure at year-end 2006.

# EBRI Account Balance by Age/Service

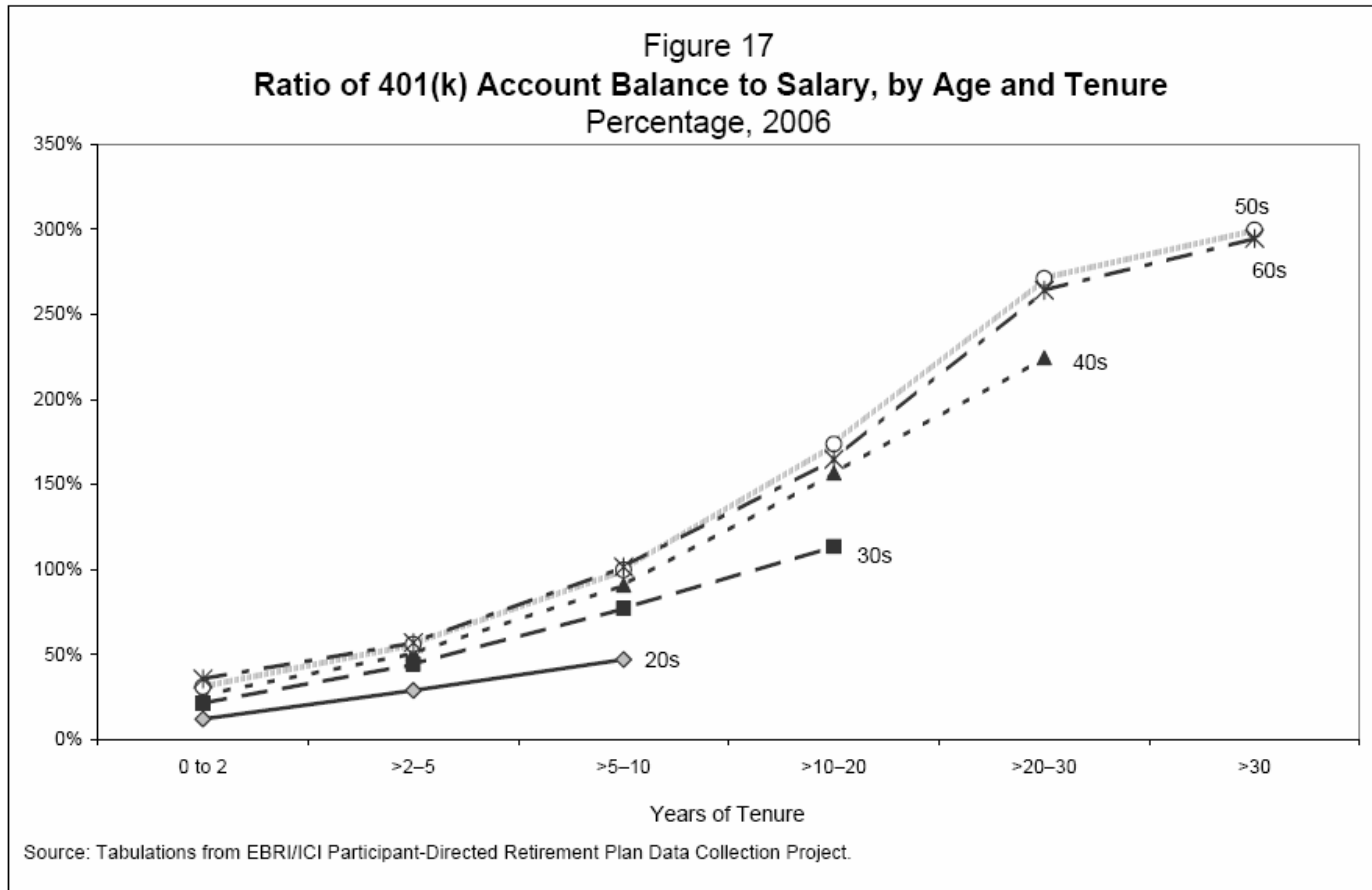
**Figure 13**  
**Account Balances Increase With Age and Tenure**  
 Average 401(k) account balance, by age and tenure, 2006

Age Group	Tenure (years)					
	0-2	>2-5	>5-10	>10-20	>20-30	>30
20s	\$4,571	\$10,414	\$17,120			
30s	\$11,257	\$22,368	\$37,438	\$55,693		
40s	\$14,725	\$29,010	\$49,995	\$89,822	\$133,321	
50s	\$17,854	\$32,532	\$54,491	\$99,794	\$174,272	\$167,806
60s	\$20,076	\$31,914	\$51,268	\$93,636	\$157,069	\$190,593

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

Note: At year-end 2006, the average account balance among all 20.0 million 401(k) participants was \$61,436; the median account balance was \$18,986.

# EBRI Ratio Account Balance/Salary



# Vanguard – Distribution Trends

Figure 64. Trends in Distribution of Plan Assets

*Vanguard defined contribution plans*

Participants with termination dates in the given year

	2000	2001	2002	2003	2004	2005	2006
<b>Percentage of participants choosing</b>							
Remain in plan	29%	31%	36%	40%	45%	47%	47%
Rollover	35	29	27	25	24	24	24
Installment payments	1	1	1	1	1	0	0
Participants preserving assets	65%	61%	64%	66%	70%	71%	71%
Cash lump sum	34%	38%	35%	32%	29%	27%	27%
Rollover and cash	1	1	1	2	1	2	2

# Vanguard – Distributions by Age

Figure 65. Plan Distribution Behavior by Age, 2006

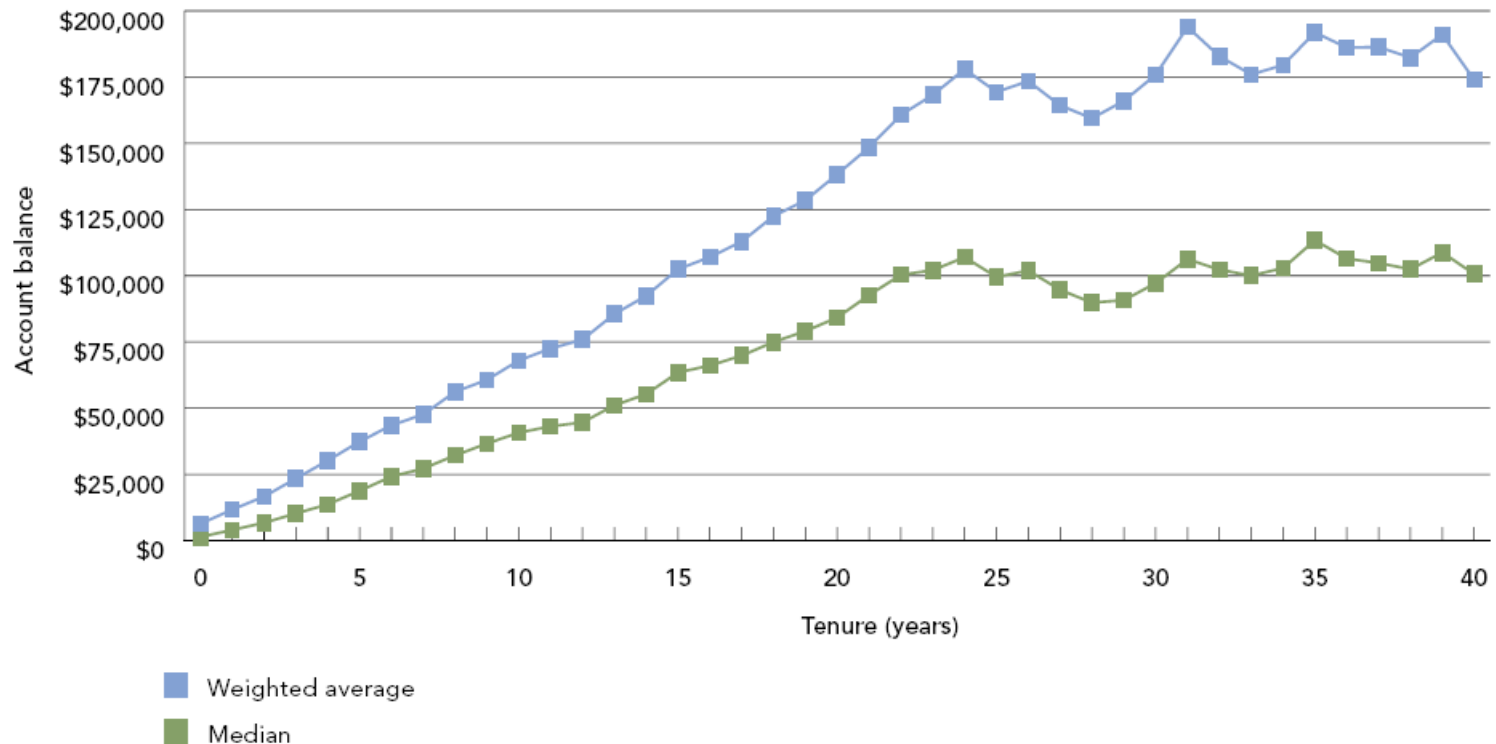
*Vanguard defined contribution plans*

Participants with termination dates in 2006

	20s	30s	40s	50s	60s	70s	Total
<b>Percentage of participants choosing</b>							
Remain in plan	48%	49%	49%	49%	38%	21%	47%
Rollover	15	19	23	30	43	32	24
Installment payments	0	0	0	0	1	10	0
Participants preserving assets	63%	68%	72%	79%	82%	63%	71%
Cash lump sum	36%	31%	26%	19%	16%	34%	27%
Rollover and cash	1	1	2	2	2	3	2

# Fidelity – Average Account Balance by tenure

2.9 Active participants' weighted average and median account balances, by tenure



Note: Tenure for all active participants was rounded down to the nearest integer number of years. Throughout this Report tenure refers to tenure as an employee of the plan sponsor, not tenure as a Fidelity-recordkept participant.

# Fidelity – Age and Tenure

## 2.10 Weighted average account balance of active participants, by age and tenure

Age	Tenure (years)									Overall
	0 to <5	5 to <10	10 to <15	15 to <20	20 to <25	25 to <30	30 to <35	35 to <40	40+	
20–29	\$7,000	\$20,000	\$22,000							\$10,000
30–39	\$16,000	\$42,000	\$59,000	\$74,000	\$70,000					\$36,000
40–49	\$22,000	\$56,000	\$84,000	\$116,000	\$145,000	\$131,000	\$115,000			\$76,000
50–59	\$26,000	\$61,000	\$90,000	\$129,000	\$174,000	\$186,000	\$178,000	\$170,000	\$153,000	\$113,000
60–64	\$27,000	\$59,000	\$88,000	\$124,000	\$162,000	\$186,000	\$217,000	\$216,000	\$176,000	\$119,000
65–69	\$25,000	\$47,000	\$75,000	\$106,000	\$145,000	\$167,000	\$214,000	\$257,000	\$257,000	\$109,000
70+	\$20,000	\$26,000	\$46,000	\$78,000	\$128,000	\$141,000	\$195,000	\$264,000	\$277,000	\$91,000
<b>Overall</b>	<b>\$16,000</b>	<b>\$48,000</b>	<b>\$77,000</b>	<b>\$114,000</b>	<b>\$156,000</b>	<b>\$166,000</b>	<b>\$181,000</b>	<b>\$187,000</b>	<b>\$199,000</b>	<b>\$68,000</b>

# Fidelity – by Age and Pay

## 2.11 Weighted average account balances of active participants, by age and compensation

Compensation	Age							Overall
	20–29	30–39	40–49	50–59	60–64	65–69	70+	
<\$10,000	\$2,000	\$9,000	\$15,000	\$24,000	\$20,000	\$13,000	\$7,000	\$11,000
\$10,000–\$19,999	\$2,000	\$6,000	\$10,000	\$16,000	\$21,000	\$16,000	\$11,000	\$9,000
\$20,000–\$29,999	\$3,000	\$7,000	\$12,000	\$19,000	\$26,000	\$28,000	\$31,000	\$11,000
\$30,000–\$39,999	\$5,000	\$11,000	\$22,000	\$33,000	\$41,000	\$44,000	\$59,000	\$19,000
\$40,000–\$49,999	\$8,000	\$18,000	\$34,000	\$52,000	\$60,000	\$65,000	\$88,000	\$31,000
\$50,000–\$74,999	\$14,000	\$30,000	\$57,000	\$87,000	\$99,000	\$101,000	\$124,000	\$55,000
\$75,000–\$99,999	\$26,000	\$50,000	\$95,000	\$140,000	\$150,000	\$148,000	\$167,000	\$95,000
\$100,000+	\$34,000	\$81,000	\$159,000	\$248,000	\$273,000	\$311,000	\$370,000	\$171,000
<b>Overall</b>	<b>\$10,000</b>	<b>\$36,000</b>	<b>\$79,000</b>	<b>\$119,000</b>	<b>\$123,000</b>	<b>\$109,000</b>	<b>\$79,000</b>	<b>\$71,000</b>