Pension Section News

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Discipline Involved in Managing a Pension Plan Can Lead to a Better 401(k) Plan

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Author's Note: A new study finds significant differences in employee savings plans according to whether the employer also sponsors a traditional pension plan.

The discipline and structured approach to plan management and decision-making that employers have applied over the years to managing their pension plans seems to carry over to the savings plan arena, with positive results. A new survey finds that employers that offer both a pension plan and a 401(k) or other employee savings plan tend to have savings plans that are more generous, use more channels for employee communication, and are more attentive to plan management activities than employers that sponsor just a savings plan.

More-generous plan features, combined with a greater focus on employee education, translates into higher employee participation levels, while a greater emphasis on policy and oversight results in fewer operational problems and compliance concerns.

The survey findings, while generally logical, are disappointing since one might hope that sponsors of defined contribution-only retirement programs would be offering the more generous plans, using all available communication channels, and paying very close attention to the plans through regular and ongoing monitoring activities.

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These are some of the findings from a survey of 252 defined-contribution plan sponsors by human resource consultant William M. Mercer, Incorporated. Nearly 60% of the respondents also sponsor a defined benefit pension plan that covers most of their employees. With this proportion steadily declining in recent years, employees are becoming increasingly reliant on savings plans as vehicles for retirement income or wealth accumulation.

Almost across the board, the survey found that defined contribution (DC) plan design features are more generous when the employer also offers a defined benefit (DB) plan. Eligibility is more liberal, vesting occurs faster, and employer contributions are more likely to have both a fixed and a discretionary component. For example, 45% of DB/DC plan sponsors have immediate vesting on the employer match, compared to 27% of DC-only sponsors.

DB/DC plan sponsors are more than twice as likely as DC-only sponsors to automatically invest company matching contributions in employer stock (26% vs. 11%, respectively).

Using employer stock as an investment vehicle helps to align employees' retirement benefits with the organization's business goals, and provides one way for the employer to raise additional capital.

Communication

On average, companies with both types of plans use more communication channels to provide information about the savings plan. They also are far more likely to offer individual counseling for terminating employees (58% vs. 39%), to target specific messages to participants who don't diversify (34% vs. 18%) and those who are nearing retirement (32% vs. 22%), and to measure the effectiveness of their communication materials (57% vs. 43%).

Management and Administration

In the plan management arena, DB/DC sponsors are significantly more likely than DC-only sponsors to have a contract with their recordkeeper (69% vs. 50%) and less likely to rely on the vendor for investment performance monitoring (35% vs. 54%).

DC-only sponsors also are more likely to identify challenges stemming from under-performing assets and compliance issues. Average employee deferral percentages were almost three-quarters of a percentage point less for DC-only sponsors.

Investments

Two-thirds (66%) of DB/DC plan sponsors have an investment policy for their defined contribution plan, compared to 45% of DC-only sponsors. Respondents with both types of plans are more likely to offer employees a stable value fund (70% vs. 57%), an indexed domestic equity fund (73% vs. 62%), and company stock for employee-directed assets (43% vs. 24%). However, it is less likely that employee direction is allowed for company matching contributions in organizations where the employer sponsors both types of plans (71%, compared to 89% for DC-only sponsors).

Other Findings

- Defined contribution plans differ according to whether the finance department or the human resource department exercises the greatest influence on plan decisions. Where the finance department holds sway, a DC plan is more likely to have a non-matching company contribution, a discretionary company contribution, performance standards with their recordkeeper that are linked to specific measures, and to have the employer pay the majority of plan fees.

- One third (33%) of respondents recently liberalized their eligibility requirements. The most important reason given for doing so is to increase participation, followed closely by the need to attract and retain employees.
- More than 90% of the surveyed plans offer employer matching contributions, with the most common amount being 50% on the first 6% of employee contributions. In most cases, the amount of the match does not depend on service, end-of-year employment, or location. Twenty-one percent of respondents reported having improved their matching contribution within the past three years. Nearly 40% of all plans have immediate vesting for employer contributions.
- Employees direct the investment of their own contributions in all of the plans. They direct the investment of matching contributions in 80% of plans, and the investment of profit sharing contributions in 85% of plans.
- The average number of investment options available for employee assets rose to 11.7 in 2000, up from 9.5 in 1998 and 4.2 in 1992, the survey found 82% of respondents increased the number of options offered between 1998 and 2000.
- Nearly half (47%) said they planned to increase the number of investment options this year or next, while 24% planned to decrease the number of available options.
- Actively managed domestic large cap equity funds are the most common investment option, included in 90% of plans. Greatest growth from 1998 to 2000 was in the percentage of plans offering lifecycle funds (rising from 17% to 26%) and brokerage and mutual fund window accounts (rising from 7% to 12%). The percentage of plans offering a company stock fund for employee-directed investments rose from 23% to 35% over the two-year period.

Table 1.

Statistically Significant Differences Between Two Types of Plan Sponsors

	Those with DB and DC plans	Those with DC plans only
Plan design		
Eligibility – no age requirement	51%	30%
Eligibility – upon hire or within three months	50%	28%
Immediate vesting on the employer match	45%	27%
Immediate vesting on the profit sharing contribution	43%	11%
Matching contribution automatically invested in company stock	26%	11%
Communication		
Use interactive computer programs	48%	38%
Use benefit fairs	52%	31%
Provide individual counseling for terminating employees	58%	39%
Target communications to participants who don't diversify	34%	18%
Target communications to employees approaching retirement	32%	22%
Measures the effectiveness of communication materials	57%	43%
Plan management and administration		
Have a recordkeeping service contract	69%	50%
Current challenge – underperforming assets	25%	37%
Current challenge – compliance issues	8%	17%
Performance monitoring report provided by vendor	35%	54%
ADP – non-highly compensated	5.27%	4.58%
ADP – highly compensated	6.23%	5.52%
Investments		
Have a formal investment policy	66%	45%
Offer a stable value fund	70%	57%
Offer an indexed domestic equity fund	73%	62%
Offer an actively managed large cap core domestic equity fund	27%	16%
Offer an actively managed mid cap domestic equity fund	38%	51%
Offer company stock for employee-directed assets	43%	24%
Employee direction allowed for company matching contribution	71%	89%

Source: William M. Mercer, Incorporated

About the Survey

Respondents represent 252 sponsors of defined contribution plans with assets totaling $125 billion. The average number of eligible employees per respondent is 8,100. Although many employers offer multiple savings plans, Mercer asked respondents to provide information on their largest defined contribution plan only. In most cases, this was a plan with a 401(k) feature. The survey results have not been weighted, and only represent the organizations surveyed.

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