WORKING PAPER
Executive Summary
OCTOBER 2009, WP# 2009-26

CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

AN UPDATE ON 401(K) PLANS: INSIGHTS FROM THE 2007 SURVEY OF CONSUMER FINANCES

BY ALICIA H. MUNNELL, RICHARD W. KOPCKE, FRANCESCA GOLUB-SASS, AND DAN MULDOON

The maturation of the 401(k) system and the enactment of the Pension Protection Act of 2006, which made 401(k) plans easier and more automatic, were expected to enhance the role that 401(k)s played in the provision of retirement income. So, originally, the release of the Federal Reserve's 2007 Survey of Consumer Finances (SCF) seemed like a great opportunity to reassess 401(k)s. But the 2007 SCF reflects a world that no longer exists. Interviews were conducted between May and December, when the Dow Jones was at 14,000 (the peak was October 9, 2007) and housing prices were only slightly off their peak.

Given the collapse of the financial markets and the economy, this paper uses the 2007 SCF data as a starting point in evaluating the condition of 401(k)s and the factors that affect participation and contributions and relies on more recent data and estimates to paint a full and current picture.

The 2007 SCF suggests that 401(k) plans were starting to function better. With the spread of automatic enrollment, a slightly higher percentage of workers were joining the plans, and with the automatic default into qualified investments, more participants were diversified. Balances were up due to the passage of time, steady contribution rates, and less leakage from the system.

An analysis of participation and contribution decisions using the 1998 and 2007 SCF confirm the changing 401(k) environment. Savings taste variables – such as a long planning horizon and amount of non-pension wealth – were important in 1998 when the participation decision was left up to the individual; by 2007, given the spread of auto-enrollment, these variables no longer had a statistically significant effect on the probability of an individual participating in a plan. Moreover, with the upsurge in plan freezes, coverage under a defined benefit plan, which had a significantly negative effect on participation in 1998, had no effect on participation in 2007.

On the contribution side, the maturation of the 401(k) system is reflected by the growing importance of age and education. When coverage applied primarily to new employees, participant contribution rates were relatively homogeneous, but as participants spent more time in the plans, contribution rates appear to increase with awareness about and proximity to retirement. The contribution equations also show an interesting pattern with respect to the employer match. Low match rates encouraged contributions in both

1998 and 2007. By 2007, however, the relationship between high match rates and the employee contribution was negative and large. It is not clear whether this relationship reflects individuals acting as target savers or merely is the result of progressive (high match rate) companies adopting automatic enrollment, which extends coverage at low match rates (at least initially).

Despite the maturation of the 401(k) system and improved participation and investment decisions, the typical individual approaching retirement had only $78,000 in 401(k)/IRA holdings. Then the financial markets collapsed, and the collapse spread to the real economy. Balances in 401(k) plans lost 30 percent of their value, reducing the median for those approaching retirement from $78,000 to $56,000. In addition, companies started cutting back on the employer match, and hardship withdrawals, while still at low levels, ticked upward. These events occurred just as the baby boom began approaching retirement, with an increasing number reliant on 401(k) balances as their only supplement to Social Security – a role for which 401(k)s were never intended.

The question arises whether the time may have come to consider returning 401(k) plans to their original position as a third tier on top of Social Security and employer-sponsored pensions. Given the demise of traditional employer pensions, such a rearrangement would require a new tier of retirement accounts. This additional protection would be helpful to those reliant solely on Social Security and to those with 401(k) plans where – for one reason or another – balances end up being very modest.

 The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) funded as part of the Retirement Research Consortium (RRC). The opinions and conclusions expressed are solely those of the authors and do not represent the views of SSA, any agency of the Federal Government, the RRC, or Boston College.

Center for Retirement Research at Boston College

Hovey House, 140 Commonwealth Avenue, Chestnut Hill, MA 02467-3808
phone 617.552.1762 fax 617.552.0191 crr@bc.edu www.bc.edu/crr