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Market Volatility and its Impact on Defined Contributions Plans

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In spite of the market turmoil over the past several months, it appears most 401k plans and their participants are not making drastic changes.

From a plan sponsor perspective, recent data suggests that the vast majority of plan sponsors are not making changes to their matching contribution formulas amid the economic downturn.

- According to recent statistics compiled by Merrill Lynch, 5% of their institutional 401k clients have eliminated their matching contributions altogether, while another 4.5% have reduced their match. 3.6% were reported to be considering changes.
- Fidelity Investments reports that only a “handful” of their 19,300 plans have suspended or terminated matching contributions.

While some changes are to be expected given the downturn’s impact on corporate earnings, these numbers suggest that plan sponsors may view the match as a stated component of their benefits structure and may be resistant to making a reduction in this area. However, depending on the depth and length of the recession, as companies find themselves reexamining all areas of their business for potential cost savings, the picture could certainly change.

In terms of participant activity, recent data shows most participants are sticking with their investments through the recent market selloff.

- According to Fidelity Investments, only 6.6% of the participants in defined contribution plans they recordkeep made an exchange during the three month period ending November 2008.
- Fidelity says 2.5% of participants made exchanges in September, 4.0% made exchanges in October and 1.8% made exchanges during November.

The Hewitt 401k Index™ also reveals some interesting trends in participant activity for those that made exchanges. The index tracks aggregate exchange activity by participants across the plans that Hewitt Associates provides recordkeeping services for. Looking at the index data from October and November 2008, the index shows the highest levels of exchange activity generally occurred the day after a significant market decline and those participant exchanges were predominantly going from equities into fixed income. However, even on the day with the highest level of participant activity for that period (October 10th), the aggregate dollar amount of participant exchanges still represented less than 1/3 of 1% of total plan balances.

It is encouraging that most participants seem to be adhering to a longer-term view of the markets, but inertia is likely a more powerful force at play here than perhaps a conscious decision to stick with their current strategy. While sweeping changes may not be in order for most plans, plan sponsors should take time to evaluate their 401k plans in the following areas:

- 1) Does the menu of funds offer participants adequate opportunity to diversify their investments across asset classes and categories (including pre-diversified investment options)?
- 2) Are there menu design strategies or plan features such as advice/guidance that might improve participants' odds of "success" in saving for retirement?
- 3) Are there additional communication/education strategies that could be of benefit to participants?
- 4) Is there an understanding of the overall fees the plan pays and the underlying investment fees borne by participants? If so, how are the fees measured to ensure they are reasonable?

For more information on Market Volatility and Defined Contribution Plans please contact Steve Spencer at spencer@dimeoschneider.com or 312-853-1000.