

Survey Results of Available Passive Options in DC Plans

Executive Summary

What is the current state of available passive options in Defined Contribution (DC) plan lineups? The question of whether to include or add index funds to a lineup is one that many plan sponsors and their advisors have contemplated at one point or another. In response, many plan sponsors have taken steps to create an index tier within their plans that enables participants to construct passive core exposure within their retirement saving accounts. However, the ubiquitous availability of S&P 500® index funds often results in inflated headline numbers regarding the availability of passive options.

To achieve a more granular perspective on the prevalence of indexing in DC plans, we conducted a survey of various plan types. We selected a random sample of plans from Standard & Poor's Money Market Directories (MMD) database (<http://mmdaccess.com>), which included 401(k), 403(b), 457, 401(a) and defined contribution (unspecified) plan types. We then created four plan segments based on plan assets:

- Small (under \$50 million)
- Mid (between \$50 million and \$200 million)
- Large (between \$200 million and \$1 billion)
- Mega (over \$1 billion)

Within each segment, we sampled over 100 plans and then retrieved the investment lineup for each from our DC investment options database, which was developed from all of the available investment options for the entire MMD plan sponsor database. We then proceeded to

determine whether or not each investment option could be categorized as a passive index fund. If it could be, then its associated benchmark was also identified.

Our research focused on U.S. equities (several categories, including large, mid, small, total market, and completion [total market minus the S&P 500]), international equities and core fixed income.

To facilitate discussion based on the results, we define two new terms: *adoption rate* and *deployment rate*. The adoption rate is the percentage of plan sponsors offering at least one passive fund for a particular asset class, in the context of the overall sample or a particular plan segment. This measure provides a sense of the prevalence of indexing in relation to the number of plans in a given group.

The deployment rate is the percentage of investment options within a given plan that are index funds. This measure provides a sense of the commitment to indexing within the plans, as it shows what portion of their investment lineup comprises passive funds.

Results from our survey show that:

- 94% of sampled DC plans offer index funds, but that headline number obscures the fact that most plans offer a single asset class with a passive option – large-cap U.S. equities.
- Other asset classes, such as mid-caps and bonds, have vastly lower passive representation in DC plans, particularly in small and mid-sized plans.

- There is a negative correlation between the number of lineup choices and the number of passive funds offered.
- There is potential for simplification of plan lineups through use of index funds.

were similar across all four tiers, as shown in Table 2 below.

High-Level Results

A total of 424 individual plans were sampled, with assets totaling approximately \$537 billion. Table 1 below shows the distribution of plan assets by segment.

Table 1 – Average Plan Size by Segment		
Total Sample:	Count	Average Plan Size
	424	\$1,266,542,696
By Plan Size:		
Mega	107	\$4,397,645,822
Large	108	\$492,317,926
Mid	104	\$107,849,317
Small	105	\$19,803,190

Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

Although there was great variety in the number of investment options used by plan sponsors, the mean and median numbers of investment options

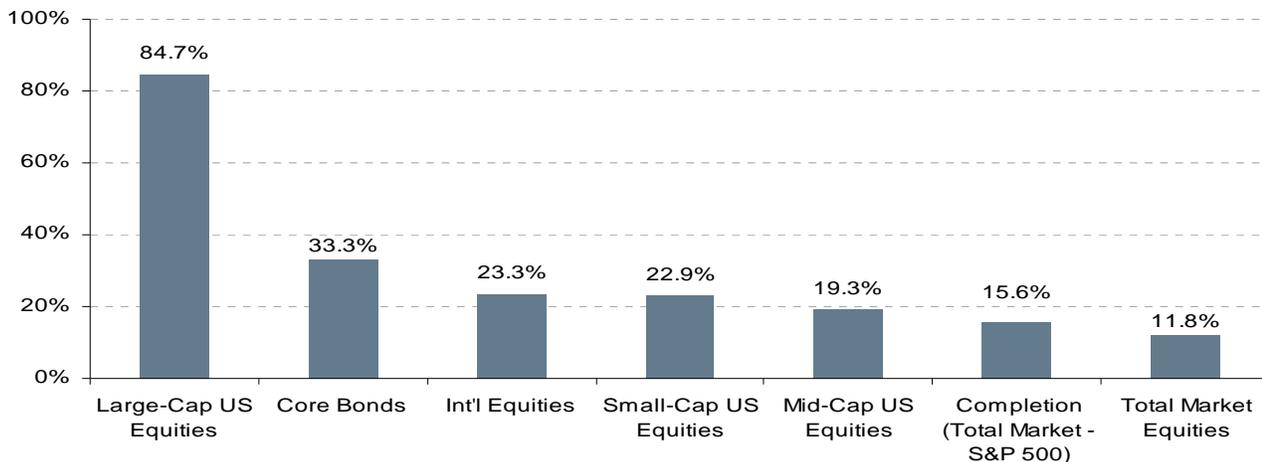
Table 2 – Number of Lineup Choices by Segment				
	Mean	Median	Max	Min
Total Sample:	17.2	14.0	356	1
By Plan Size:				
Mega	14.8	14.0	85	4
Large	19.5	15.0	356	7
Mid	15.7	14.5	66	1
Small	18.9	14.0	119	2

Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

Prevalence of Passive Funds

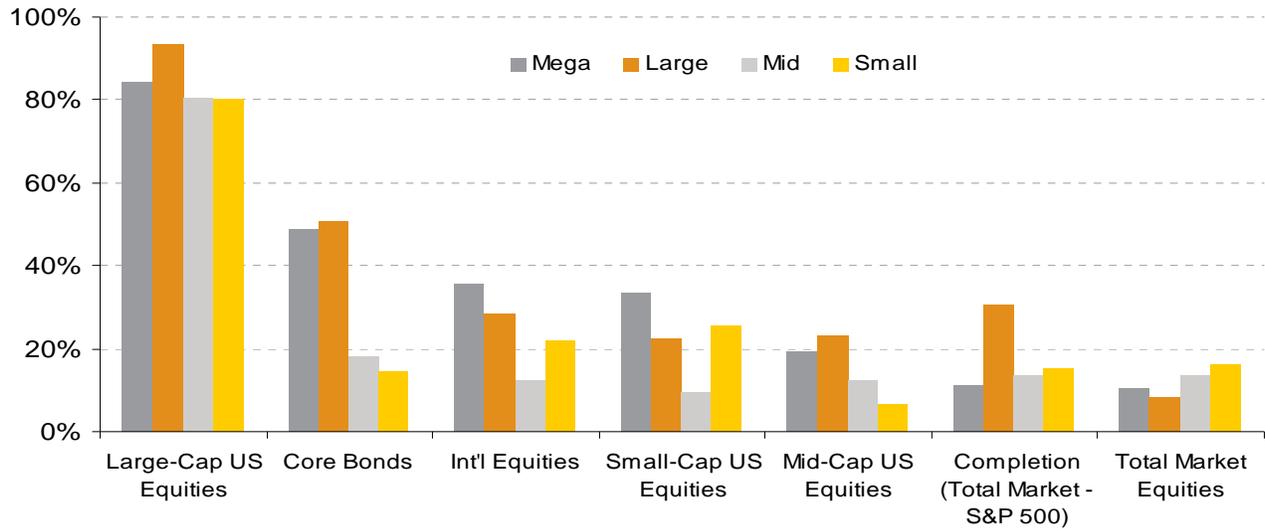
It is worth noting that 398 of the 424 (94%) plans sampled offer at least one index fund. However, the high overall adoption rate obscures much lower rates across asset classes other than large-cap stocks. Chart 1 below shows the asset classes and categories we considered and the percentage of plans that offer an index fund. Almost 85% of plans surveyed offer a large-cap index fund, but the numbers drop off dramatically for other asset classes.

Chart 1 – Index Fund Adoption is Concentrated in U.S. Large-Cap Equities



Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

Chart 2 – Large-Cap Index Fund Adoption is Relatively Uniform Across Plan Segments, While Adoption of Other Asset Classes Varies More

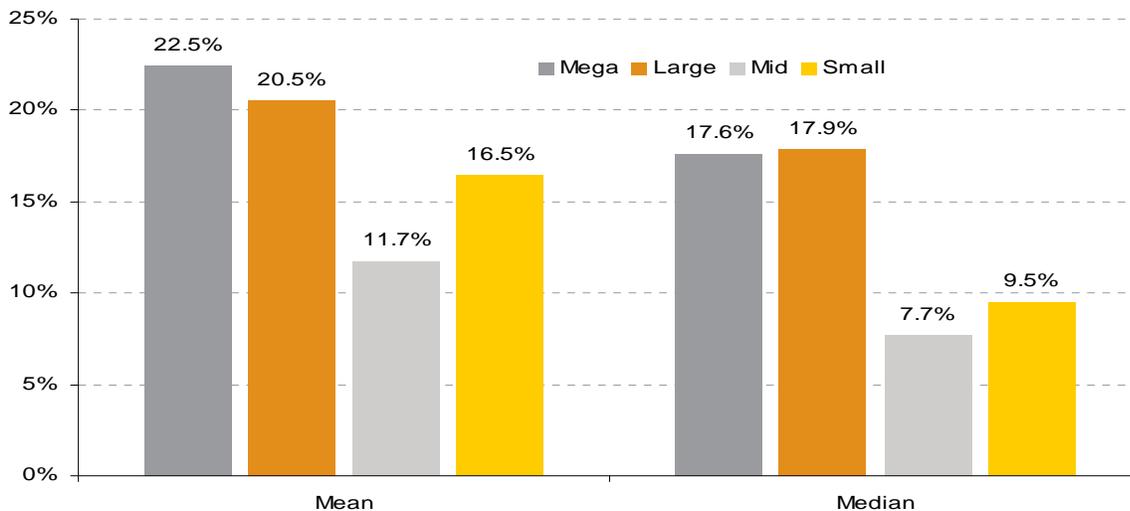


Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

Chart 2 above breaks out adoption rates by plan segment, as well as, by asset class. Large-cap displays greater uniformity of adoption rate across plan segments than most other asset classes. The general tendency is for higher rates of index fund adoption in large and mega plans, compared to mid and small plans.

While Charts 1 and 2 consider adoption rates across asset classes and plan segments, Chart 3 shows that index fund deployment rates are somewhat higher in large and mega plans than they are in mid and small plans. This means that in larger plans, on average, more of the investment lineups are devoted to passive alternatives than in those of smaller plans.

Chart 3 – Index Fund Deployment Rates are Generally Higher in Large and Mega Plans

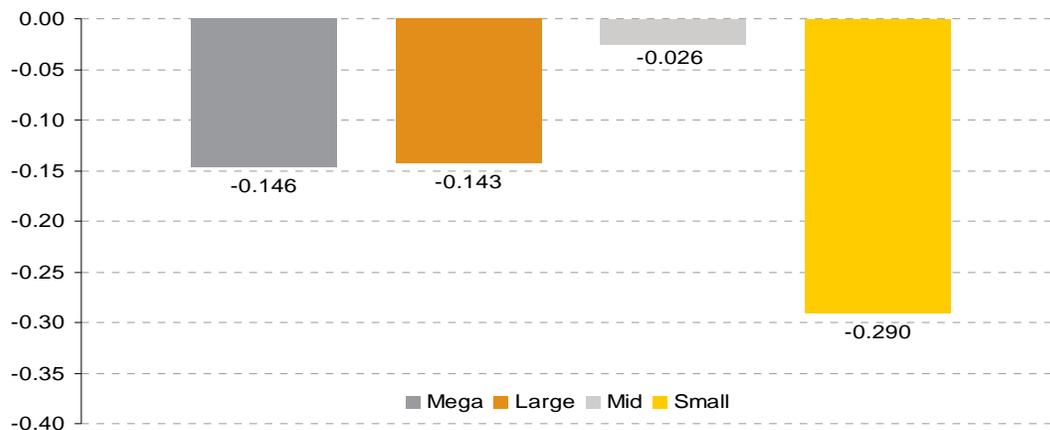


Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

As previously indicated in Table 2, some plans offer a large number of investment choices in their lineups. We measured the relationship between the number of investment options available and the index fund deployment rate and found a negative

correlation. Therefore, it would appear that a large number of plans could simplify their lineups in two ways: by reducing the number of options and increasing the number of index funds. Chart 4 below illustrates this relationship.

Chart 4 – The Correlation of the Number of Investment Options to the Index Fund Deployment Rate is Negative: Plans Can Simplify Lineups by Reducing the Number of Choices While Increasing Their Use of Index Funds



Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

Benchmark Indices

Next, we consider the underlying benchmarks for index funds used by DC plans. Benchmark indices identified in this plan sample are listed in Table 3 below.

Table 3 – Index Exposures Available in Plan Sample

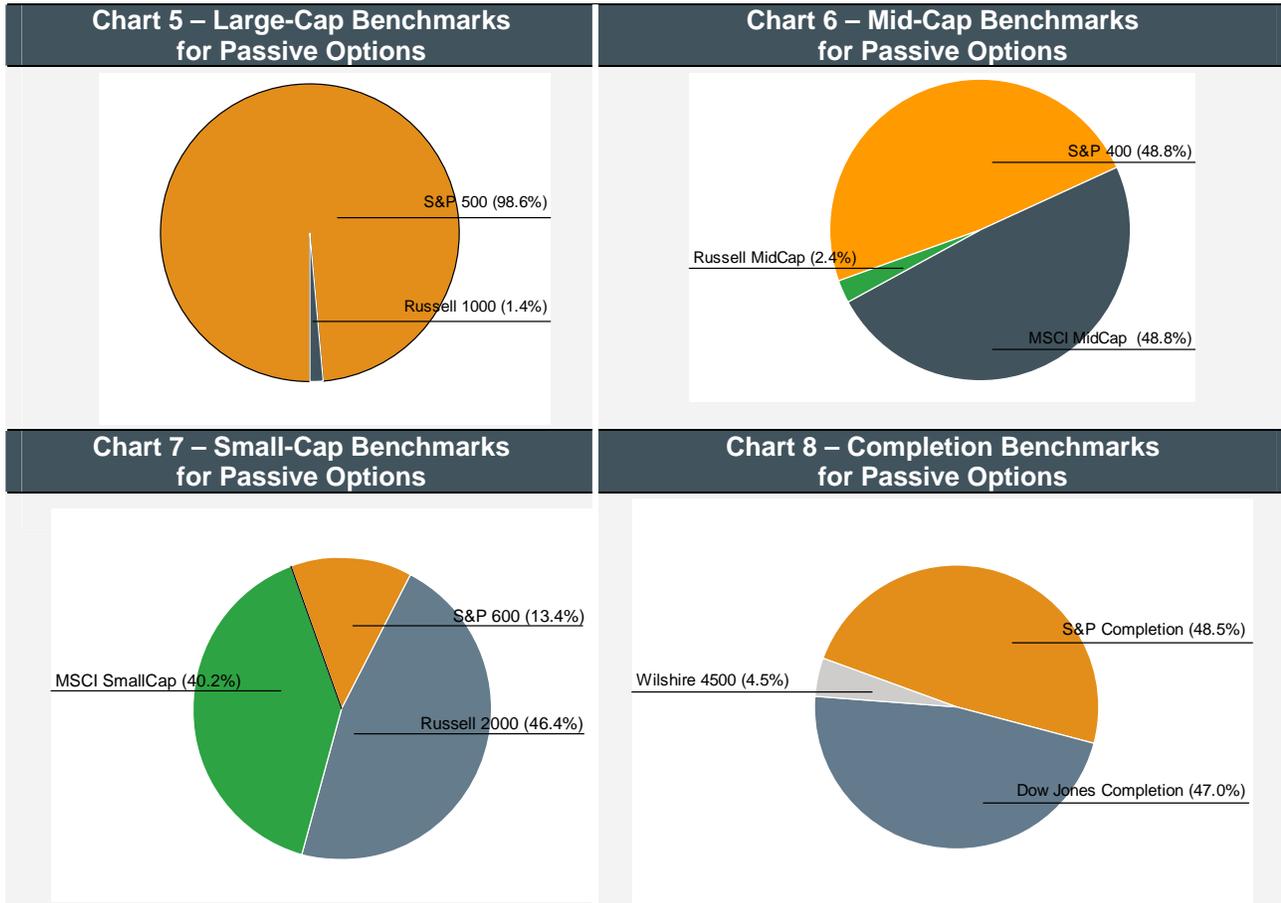
Market Segment	U.S. Large-Cap	U.S. Mid-Cap	U.S. Small-Cap
	S&P 500	S&P MidCap 400	S&P SmallCap 600
	Russell 1000	Russell Mid Cap	Russell 2000
		MSCI Mid Cap	MSCI Small Cap
Broad Market	U.S. Completion	U.S. Total Market	
	S&P Completion	S&P TMI	
	DJ Completion	Russell 3000	
	Wilshire 4500	MSCI US Broad	
		DJ TMI	
		Wilshire 5000	
Others	International Equity	Fixed Income	
	MSCI EAFE	Barclays U.S. Aggregate	
	MSCI EAFE + EM		

Source: Money Market Directory.

Exposure to the S&P 500 accounted for 96%-100% of large-cap passive investment options across plan segments. Exposure to the S&P MidCap 400[®] accounted for the majority of mid-cap investment options for small and mega plans; whereas the MSCI Mid Cap Index had more exposure in mid and large plans. Russell’s small-cap and total market indices were more widely used

for plans in the small and mega tiers, while the MSCI Smallcap benchmark was more frequently used in the mid and large plans.

Charts 5 through 8 highlight the relative market shares of the various benchmark indices for select asset types, for all tiers combined.



Source: Money Market Directory. Data as of April 2011. Charts are provided for illustrative purposes only.

MSCI EAFE exposure accounted for 100% of the share of international indices for small, mid and large plans, and 92% of the share for mega plans. Barclays U.S. Aggregate Bond Market Index was the only bond index investment option across all plan sizes.

Summary

Despite the relatively small number of plans included in this randomly-drawn DC plan sample, the survey results are illuminating in a number of ways. Overall there were large discrepancies

between the adoption rates of passive investment options by plan sponsors in this survey, across asset types, as well as across plans of different sizes. Large-cap indices are available in approximately 85% of all plans sampled, while passive representation of other asset classes is significantly lower, particularly in mid and small plans. Deployment rates of index funds are generally higher in mega and large plans than in mid and small plans, and we found a negative correlation between the number of lineup options and the availability of index funds. Many plans could greatly simplify their lineups by reducing the number of investment options while increasing the use of index funds.

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