Retirement Income
JOURNAL

How “streamlining” a retirement plan pays off

By Editorial Staff *Thu, Jan 14, 2016*

A team of Wharton School professors documented the positive effects of reducing the number of investment options at a large non-profit institution's retirement plan to 39 from about 90 funds.

“Don’t confuse participants with too many fund choices” has been the mantra of some retirement plan designers for years, and plan sponsors have embraced it in principal if not always in practice.

A study written by Donald Keim and Olivia Mitchell of The Wharton School and published this week by the National Bureau of Economic Research adds nuance and weight to this now-conventional wisdom.

Their paper, entitled, “Simplifying Choices in Defined Contribution Retirement Plan Design,” offers the case of an unidentified nonprofit employer that cut 39 funds from its plan’s 90-fund lineup and required the participants who had held deleted funds to either reallocate to any of the remaining funds, default into a target date fund (TDF), or go to a brokerage account.

Use of TDFs increased as a result of the “streamlining.” Participants who defaulted to a TDF increased their average equity exposure slightly while participants who chose their own new sets of funds, including TDFs, reduced their average equity exposure by 4.8%, leading to projected gains for all.

Participants who were affected by the switch to a smaller fund lineup “exhibited significantly lower within-fund turnover rates and expense ratios, and we estimate this could lead to aggregate savings for these participants over a 20-year period of $20.2M, or in excess of $9,400 per participant,” wrote Mitchell and Keim.

“The most interesting finding, both statistically and economically, is that the overall re-allocations *into* TDFs seen in Table 6 prove to be 10% larger, and the re-allocations *out of* stock funds 7.6% larger, for the low-income members of the Plan-Defaulted group. In other words, the streamlining reform had a larger impact on low-income savers, making their portfolios better balanced and less risky than before.”