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News from EBRI

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New Research from EBRI:

Analysis Estimates Impact of Market Losses on 401(k) Account Balances

WASHINGTON—The nonpartisan Employee Benefit Research Institute (EBRI) today published an analysis of the impact of the recent financial crisis on 401(k) retirement account balances from Jan. 1, 2008, to Jan. 20, 2009, showing that participants' losses were largely determined by their account balance, age, and job tenure.

The EBRI analysis, published in the February 2009 *EBRI Issue Brief*, used the EBRI/ICI 401(k) database of more than 21 million participants to estimate the impact of market activity on 401(k) account balances. During 2008, major U.S. equity indexes were sharply negative, with the S&P 500 Index losing 37 percent for the year, which translated into corresponding losses in 401(k) plan assets.

Here are some of the key points in the EBRI analysis*:*

- **Impact varies by account balance:** Not surprisingly, how the recent financial market losses affect individual 401(k) account balances is strongly affected by the size of a participant's account balance. Those with low account balances relative to contributions experienced minimal investment losses that were typically more than made up by contributions: Those with less than $10,000 in account balances had an average growth of 40 percent during 2008, since contributions had a bigger impact than investment losses. However, those with more than $200,000 in account balances had an average loss of more than 25 percent.
- **Impact varies by age and job tenure:** 401(k) participants on the verge of retirement (ages 56–65) had average changes during this period that varied between a positive 1 percent for short-tenure individuals (one to four years with the current employer) to more than a 25 percent loss for those with long tenure (more than 20 years).
- **Short-term vs. long-term:** While much of the focus has been on market fluctuations in the last year, investing for retirement security is (or should be) a long-term proposition. When a consistent sample of 2.2 million participants who had been with the same 401(k) plan sponsor for the seven years from 1999–2006 was analyzed, the average estimated growth rates for the period from Jan. 1, 2000, through Jan. 20, 2009, ranged from 29 percent for long-tenure older participants to more than 500 percent for short-tenure younger participants.
- **Recovery time and future stock market performance:** The analysis also calculates how long it might take for end-of-year 2008 401(k) balances to recover to their beginning-of-year 2008 levels, before the sharp stock market decline. Because future performance is unknown, this analysis provides a range of equity returns: At a 5 percent equity rate-of-return assumption, those with longest tenure with their current employer would need nearly two years at the median to recover, but approximately five years at the 90th percentile. If the equity rate of return is assumed to drop to zero for the next few years, this recovery time increases to approximately 2.5 years at the median and nine to 10 years at the 90th percentile.
- **Near-elderly with very high equity exposure:** Estimates from the EBRI/ICI 401(k) database show that many participants near retirement had exceptionally high exposure to equities. Nearly 1 in 4 between ages 56–65 had more than 90 percent of their account balances in equities at year-end 2007, and more than 2 in 5 had more than 70 percent. As a result of the Pension Protection Act of 2006, many 401(k) plan sponsors appear to be offering lifecycle/target-date funds, which automatically rebalance asset investments into more "age appropriate" allocations. Had all 401(k) participants been in the average target-date fund at the end of 2007, 40 percent of the participants would have had at least a 20 percent decrease in their equity concentrations, and consequently, might have mitigated their losses, sometimes to an appreciable extent.