

# The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at ERISA 403(b) Plans

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## THE BRIGHTSCOPE/ICI DEFINED CONTRIBUTION PLAN PROFILE

*The BrightScope/ICI Defined Contribution Plan Profile* is a collaborative research effort between BrightScope and the Investment Company Institute that analyzes plan-level data gathered from audited Form 5500 filings of private-sector defined contribution (DC) plans, providing unique, new insights into private-sector DC plan design. The research draws from information collected in the BrightScope Defined Contribution Plan Database. The database is designed to shed light on DC plan design across many dimensions, including the number and type of investment options offered; the presence and design of employer contributions; features of automatic enrollment; the types of recordkeepers used by DC plans; and changes to plan design over time. In addition, industrywide fee information is matched to investments in DC plans allowing analysis of the cost of DC plans. *The BrightScope/ICI Defined Contribution Plan Profile* supplements existing plan sponsor surveys and research based on recordkept data, and it is designed to increase public understanding in this critical area of retirement savings. The first report in the *BrightScope/ICI Defined Contribution Plan Profile* series focused primarily on private-sector 401(k) plans. This report analyzes nearly 4,000 ERISA 403(b) plans in an attempt to better understand these plans.

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# The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at ERISA 403(b) Plans

## Key Findings

- » **403(b) plans are tax-advantaged retirement savings plans offered by public educational institutions, nonprofit employers (e.g., research foundations, hospitals, private educational institutions), and church organizations.** The study of 403(b) plans is complicated because plan sponsors span public and private sectors; in addition, some plans are subject to the Employee Retirement Income Security Act of 1974 (ERISA) and some are not. ERISA 403(b) plan assets account for about 40 percent of estimated total 403(b) plan assets. This report analyzes 403(b) plans covered by ERISA that also file audited Form 5500 reports (typically plans with 100 participants or more).
- » **403(b) plans offer employees a wide variety of investment options.** In 2012, the average ERISA 403(b) plan offered 23 core investment options—of those, about 10 were equity funds, three were bond funds, and seven were target date funds. Nearly all plans offered at least one equity and bond fund, about 70 percent of plans offered a suite of target date funds, and 84 percent offered fixed annuities. Historically, 403(b) plans had few restrictions in their provider- and investment-option lineups, and if all investments in ERISA 403(b) plans are counted (no matter how small), ERISA 403(b) plans have an average of 41 investment options. Investment options include mutual funds, variable annuities, and fixed annuities.
- » **Mutual funds were the most common investment vehicle in ERISA 403(b) plans.** Mutual funds held 47 percent of ERISA 403(b) plan assets in 2012. Variable annuities held 27 percent of assets, and fixed annuities were 26 percent.
- » **Equity funds accounted for the largest share of assets in ERISA 403(b) plans.** In 2012, 43 percent of ERISA 403(b) plan assets were held in equity funds, 15 percent was held in balanced funds (with most of that being held in target date funds), and more than 8 percent was held in bond funds. Fixed annuities accounted for 26 percent of ERISA 403(b) plan assets.
- » **Target date funds have become more common in ERISA 403(b) plans since 2009.** In 2009, 51.4 percent of ERISA 403(b) plans included target date funds in their core investment lineups; this had risen to 68.5 percent of plans by 2012. Similarly, the percentage of participants who were offered core target date funds increased from 71.0 percent of participants to 79.5 percent between 2009 and 2012, and over the same period, the percentage of assets invested in target date funds increased from 6.7 percent to 12.3 percent.
- » **Index funds are widely available in ERISA 403(b) plans and represented about 14 percent of ERISA 403(b) plan assets in 2012.** Index funds held the greatest share of assets in the largest ERISA 403(b) plans: almost one-fifth of the assets of ERISA 403(b) plans with more than \$1 billion in plan assets were invested in index funds. Index funds, which tend to be equity index funds, generally have lower expense ratios than actively managed equity funds.

- » **Nearly four in five ERISA 403(b) plan sponsors made employer contributions to their plans, including three in 10 following simple match formulas.** With a simple match formula, the employer matches a certain percentage of employee contributions up to a maximum percentage of employee salary. Thirty-one percent of ERISA 403(b) plans had a simple match formula in 2012. Other types of employer matches accounted for 2 percent of plans, while employers made other types of contributions (such as percentage of salary and lump-sum contributions, contributed without regard to employee contributions) in 46 percent of plans. Twenty-two percent of ERISA 403(b) plans had no employer contributions. The most common simple matching formula in 2012 was matching 100 percent of contributions up to 5 percent of salary (in 15 percent of plans with simple matches).
- » **Among ERISA 403(b) plans with automatic enrollment, the most common default initial contribution rate was 3 percent of employee salary.** In 2012, 43 percent of plans with auto-enrollment used a contribution rate of 3 percent of salary as their auto-enrollment default. Nineteen percent of plans had a default initial contribution rate of 2 percent, 14 percent had a default initial contribution rate of 4 percent, and 13 percent had a default initial contribution rate of 5 percent or more.
- » **The BrightScope measure of ERISA 403(b) total plan costs has decreased since 2009, looking at snapshots of 403(b) plan fees.** In 2012, the average total plan cost was 0.75 percent of assets, down from 0.80 percent in 2009. The average participant was in a lower-cost plan, with a total plan cost of 0.58 percent of assets in 2012 (down from 0.68 percent in 2009), while the average dollar was invested in a plan with a total plan cost of 0.51 percent in 2012 (down from 0.59 percent in 2009). BrightScope's measure of total plan cost includes administrative, advice, and other fees from Form 5500 filings, as well as asset-based investment management fees.
- » **Mutual fund expenses in ERISA 403(b) plans tend to be lower in larger plans and have trended down over time.** For example, the average asset-weighted expense ratio for domestic equity mutual funds was 0.81 percent for ERISA 403(b) plans with less than \$1 million in plan assets, compared with 0.48 percent for plans with more than \$1 billion in plan assets. Mutual fund expense ratios also have tended to decrease in ERISA 403(b) plans between 2009 and 2012. Mutual fund fees are the total expense ratio as a percentage of assets.



# Introduction

## The Role of 403(b) Plans in U.S. Retirement Planning

A 403(b) plan is an employer-sponsored defined contribution (DC) retirement plan that enables employees of public schools and universities, nonprofit employers, and church organizations to make tax-deferred contributions from their salaries to the plan.<sup>1</sup> Individual accounts in 403(b) plans can be set up as annuity contracts through insurance companies; custodial accounts, which can invest in mutual funds; or “retirement income accounts” set up for church employees, which can invest in annuities or mutual funds, among other things.<sup>2</sup> Employers also may make contributions into employee accounts. With \$0.9 trillion in assets at year-end 2014, 403(b) plans have grown to be a significant component of the U.S. retirement system (Exhibit I.1).

Section 403(b) was added to the Internal Revenue Code in 1958, and the original regulations governing the plans were issued in 1964.<sup>3</sup> It was not until 2007 that a comprehensive revision of the regulations effectively began to transform 403(b) plans from primarily employee-controlled individual-focused tax-deferred accounts to more formally developed plans, clarifying and expanding plan sponsors’ responsibilities. The 2007 regulations, which were generally effective after January 1, 2009, required

all 403(b) plans to have a written plan for the first time.<sup>4</sup> The new regulations imposed more stringent requirements for monitoring employee loans, hardship withdrawals, transfers, and other distributions. These changes have made it more difficult for employers to maintain multi-vendor plans and have resulted in some plan sponsors doing comprehensive reviews of vendors and investment lineups with the aim of streamlining and monitoring their plans more closely.<sup>5</sup> The new regulations also expanded the reporting requirements of 403(b) plans covered by the Employee Retirement Income Security Act of 1974 (ERISA).<sup>6</sup>

Typically, 403(b) plan participants direct the investment of their accounts. In a formal plan arrangement, the employer selects service providers and investment options, and participants choose from the lineup of options offered in the plan. If the plan falls under ERISA, the plan sponsor files a Form 5500 report with the Department of Labor, typically annually. In other cases, the employer acts more as a conduit to allowing service providers to offer their investment choices to employees, and the employee selects a service provider and the funds or annuities offered in that provider’s lineup.<sup>7</sup> As an example of this latter approach, data for 2009 for the 403(b) plans for K-12 school employees in the states of California and Texas indicate that each plan had more than 50 service providers and more than 3,000 investment options.<sup>8</sup>

### ERISA 403(b) PLAN

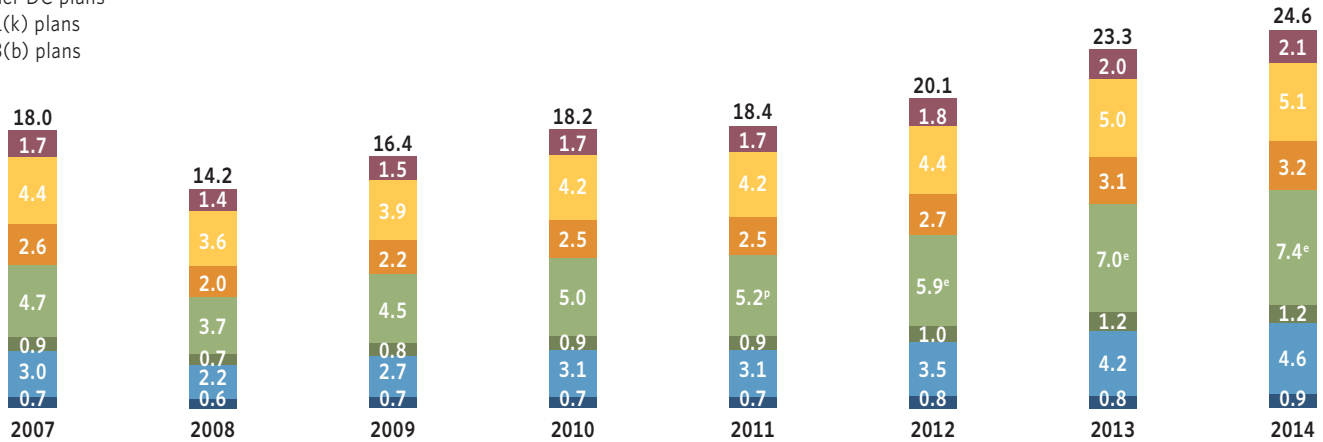
In this report, the term *ERISA 403(b) plan* refers to 403(b) plans filing the Form 5500 with the Department of Labor (DOL). Generally, 403(b) plans are offered by 501(c)(3) nonprofit employers; public school systems and universities; public hospitals; and church organizations. The private-sector nonchurch nonprofits that are covered by ERISA must file the Form 5500 with the DOL. The BrightScope Defined Contribution Plan Database contains information from the audited Form 5500 reports for these ERISA 403(b) plans, and this report presents analysis of those data. The ERISA 403(b) plan universe holds about 40 percent of all 403(b) plan assets, and the ERISA 403(b) plans with audited Form 5500 reports analyzed here represent 86 percent of the ERISA 403(b) universe plan assets.

EXHIBIT I.1

**403(b) Plans Hold \$0.9 Trillion in Assets**

Trillions of dollars; year-end, selected years

- Annuities<sup>1</sup>
- Federal, state, and local government pension plans<sup>2</sup>
- Private defined benefit plans
- IRAs
- Other DC plans<sup>3</sup>
- 401(k) plans
- 403(b) plans



<sup>1</sup> Annuities include all fixed and variable annuity reserves at life insurance companies less annuities held by IRAs, 403(b) plans, 457 plans, and private pension funds. Some of these annuity reserves represent assets of individuals held outside retirement plan arrangements and IRAs; however, information to separate out such reserves is not available. Because ICI estimates of annuities held in IRAs, 457 plans, and 403(b) plans are netted from the Federal Reserve Board's financial accounts' annuities total and reported in their respective categories by ICI, ICI reports a lower annuities total than in the financial accounts (see Federal Reserve Board 2015).

<sup>2</sup> Federal pension plans include U.S. Treasury security holdings of the civil service retirement and disability fund, the military retirement fund, the judicial retirement funds, the Railroad Retirement Board, and the foreign service retirement and disability fund. These plans also include securities held in the National Railroad Retirement Investment Trust.

<sup>3</sup> Other DC plans include 457 plans, private employer-sponsored DC plans without 401(k) features, and the Federal Employees Retirement System (FERS) Thrift Savings Plan (TSP).

<sup>p</sup> Data are preliminary.

<sup>e</sup> Data are estimated.

Note: Components may not add to the total because of rounding.

Sources: Investment Company Institute, Federal Reserve Board, Department of Labor, National Association of Government Defined Contribution Administrators, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division; see Investment Company Institute 2015b

The study of 403(b) plans is complicated because there is not comprehensive reporting across the wide array of plan sponsors. Plan sponsors span public and private sectors; in addition, some plans are subject to ERISA—for which there is comprehensive Form 5500 reporting—and some are not. ERISA 403(b) plan assets account for about 40 percent of estimated total 403(b) plan assets (Exhibit I.2).<sup>9</sup>

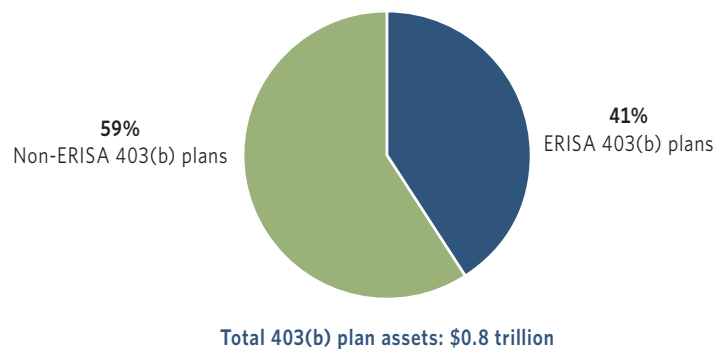
403(b) plan sponsors cover a wide range of business endeavors. ERISA 403(b) plan sponsors hail from 501(c)(3) nonprofit organizations including educational services (e.g., private

schools and private universities); hospitals; other healthcare; social assistance organizations; religious, grantmaking, civic, professional, and similar organizations; arts, entertainment, and recreation; and other (e.g., research institutions) (Exhibit I.3). Educational services account for 24 percent of ERISA 403(b) plans and 49 percent of assets, but hospitals account for 48 percent of ERISA 403(b) plan participants. This report analyzes 403(b) plans covered by ERISA that also file audited Form 5500 reports (typically plans with 100 participants or more).

EXHIBIT I.2

**ERISA 403(b) Plans Cover About 40 Percent of Total 403(b) Plan Assets**

Percentage of total, 2012



Note: ERISA 403(b) plans are those that file Form 5500 with the Department of Labor (see the callout box on page 9).

Sources: Investment Company Institute, Federal Reserve Board, and BrightScope Defined Contribution Plan Database

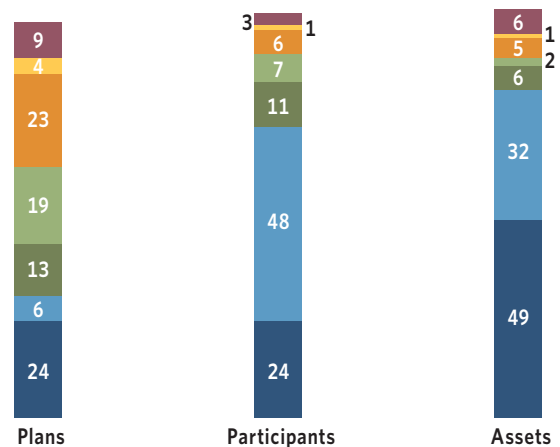
EXHIBIT I.3

**ERISA 403(b) Plans Cover Many Different Nonprofits**

Percentage of 403(b) plans, participants, or assets (2012)

**Business activity**

- Other
- Arts, entertainment, and recreation
- Religious, grantmaking, civic, professional, and similar organizations
- Social assistance
- Other healthcare
- Hospitals
- Educational services



Note: Business activity is based on Form 5500 codes for principal business activity. The exhibit includes the full Department of Labor 403(b) universe: 22,452 plans, 6.3 million participants, and \$314.9 billion in assets (see Exhibit I.4). Components may not add to 100 percent because of rounding.

Source: BrightScope Defined Contribution Plan Database

## The BrightScope Defined Contribution Plan Database

In order to better understand DC retirement plans, BrightScope has created the BrightScope Defined Contribution Plan Database, which is compiled by extracting information from audited reports filed annually by larger private-sector DC plans with the Department of Labor (DOL). Generally, plans with 100 participants or more are required to file an audited report with the DOL.<sup>10</sup> These reports generally contain information on the investments offered by the plan, assets in these investments, employer contribution structures, and design of auto-enrollment features. BrightScope also has included existing information from the Form 5500, which employer-sponsored pension

plans falling under ERISA are required to file with the DOL annually.<sup>11</sup> These filings contain important information about the plans, including the number of participants covered, total plan assets, and total contributions to and distributions from the plan. In addition, BrightScope has combined the audited data with outside data sources to incorporate the fees paid by 403(b), 401(k), and other DC participants associated with the investments in their plans. For this report, data for nearly 4,000 ERISA 403(b) DC plans are analyzed (Exhibit I.4). For 2012, the BrightScope Defined Contribution Plan Database contains audited information on nearly 18 percent of ERISA 403(b) plans, covering nearly 76 percent of ERISA 403(b) plan participants and 86 percent of ERISA 403(b) plan assets (Exhibit I.5).

### EXHIBIT I.4

#### Audited ERISA 403(b) Plans and the Universe of ERISA 403(b) Plans by Plan Assets

*Distribution of 403(b) plans, participants, and assets by plan assets (2012)*

Plan assets	Audited 403(b) filings			Department of Labor 403(b) universe		
	Plans	Participants Thousands	Assets Billions of dollars	Plans	Participants Thousands	Assets Billions of dollars
Less than \$1M	227	59.3	\$0.1	12,214	364.1	\$3.6
\$1M to \$10M	1,553	424.1	6.8	7,385	1,122.0	23.9
>\$10M to \$50M	1,257	758.4	30.6	1,884	1,058.5	42.2
>\$50M to \$100M	366	559.7	25.7	409	614.4	28.8
>\$100M to \$250M	308	917.3	47.4	338	1,002.1	51.6
>\$250M to \$500M	117	643.8	41.1	122	671.8	42.7
>\$500M to \$1B	56	579.5	39.7	59	593.4	41.7
More than \$1B	40	785.6	79.3	41	833.3	80.5
All plans	3,924	4,727.9	270.7	22,452	6,259.6	314.9

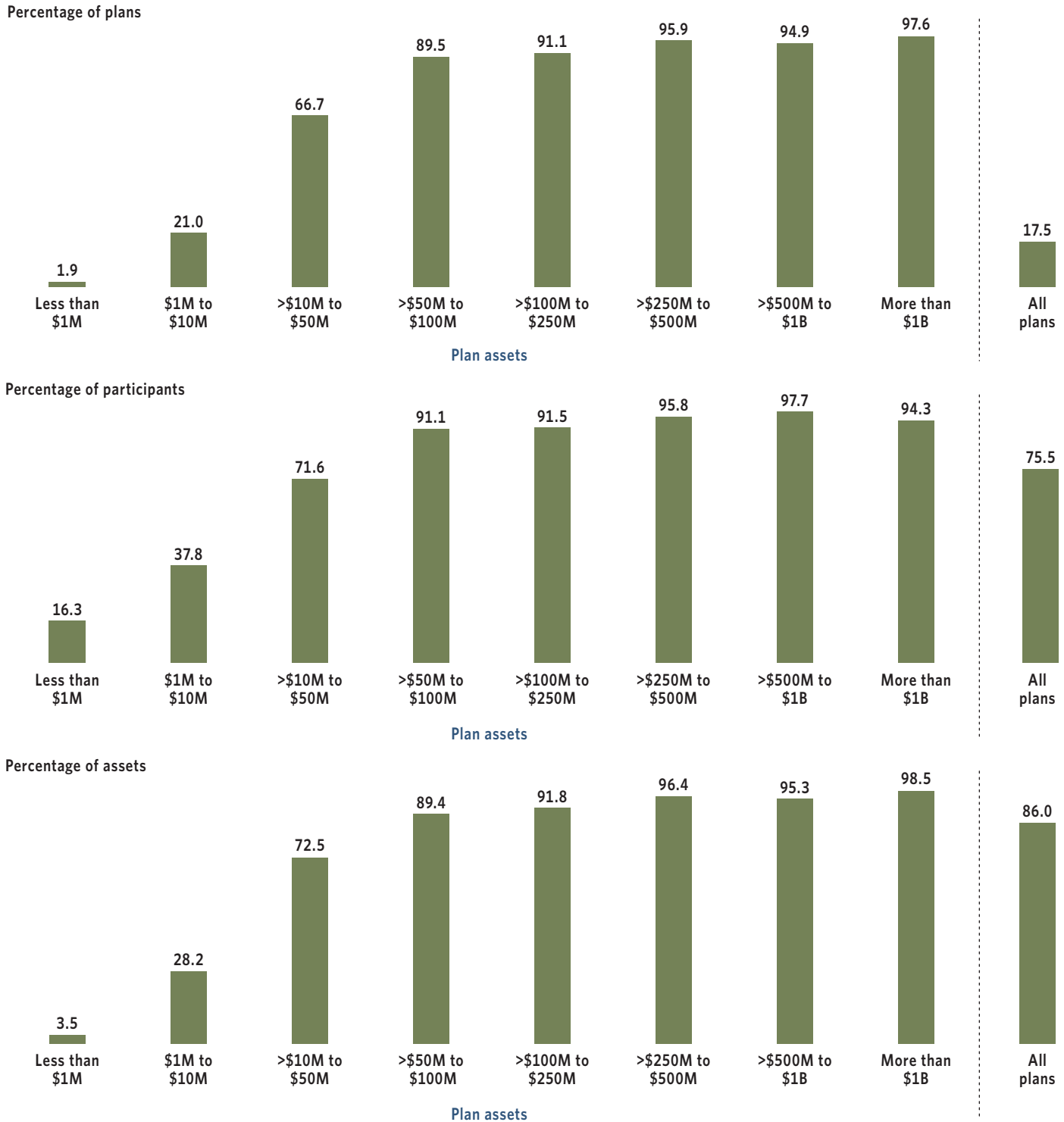
Note: Audited 403(b) filings generally include plans with 100 participants or more. Components may not add to the total because of rounding. Assets are fair market value at the year-end of the plan and include loans.

Source: BrightScope Defined Contribution Plan Database

EXHIBIT I.5

**Audited ERISA 403(b) Plans' Share of the ERISA 403(b) Universe by Plan Assets**

Share of Department of Labor 403(b) universe in audited 403(b) filings in the BrightScope database by plan assets, 2012



Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more.

Source: BrightScope Defined Contribution Plan Database

Because 403(b) plans with fewer than 100 participants are generally not required to file the audited reports required of larger plans, the BrightScope Defined Contribution Plan Database does not contain many small plans. While most ERISA 403(b) plans are small plans, most participants and assets are in larger plans. For example, although the sample analyzed contains information on nearly 4,000, or nearly 18 percent, of the nearly 22,500 plans in the DOL 403(b) universe, it contains \$270.7 billion, or 86 percent, of the \$314.9 billion in ERISA 403(b) plan assets (Exhibit I.4). Coverage rates in the database are higher for larger plans. While the database contains audited information on only 1.9 percent of plans with less than \$1 million in plan assets, more than 90 percent of plans with more than \$100 million are included (Exhibit I.5). Coverage rates of ERISA 403(b) plans in the database grouped by number of plan participants tell a similar story, with larger plans much more likely to be included than smaller plans (Exhibit I.6).

While other detailed research on 403(b) plans has tended to focus on one provider<sup>12</sup> or a particular specific group of plans,<sup>13</sup> the BrightScope database provides detailed insight into the wide cross-section of ERISA 403(b) plans filing audited Form 5500 reports with the DOL. The BrightScope database also allows for analysis of the variation in mutual fund fees across different 403(b) plan sizes. In addition, by combining mutual fund expense data with expenses on other assets as well as other fees and expenses paid for the operation of 403(b) plans, BrightScope builds a total plan cost measure for many plans. This provides a comprehensive description of the range of fees and expenses incurred in 403(b) plans.

## Research Agenda for This Report

This report focuses on plan year 2012, presenting data on how ERISA 403(b) plans are structured and the fees and expenses paid by 403(b) participants for these services.

Chapter 1 focuses on the structure of the 403(b) plans, analyzing the number and types of investment options that participants have to choose from, as well as the investment options that the participants do choose. 403(b) plan design has been trending toward selecting a “core” investment lineup—reducing redundancies by limiting the number of providers and streamlining investment offerings. This core investment lineup also improves plan sponsors’ ability to monitor the plans. Thus, the main focus of this chapter is on investments likely reflecting current plan design—core investments, although plan participants may still be holding investments offered in the plan in the past. Because target date funds have continued to become more prevalent in 403(b) plans over the past several years, this chapter explores how often they are offered in plans, what portion of plan assets are dedicated to these funds, and how these measures have changed in recent years. This chapter also explores the role of index funds in ERISA 403(b) plan investing.

Chapter 2 reports information about employer contribution structures and automatic enrollment design features. In designing their 403(b) plans, employers decide if and how much they will contribute to participants’ accounts, when participants will be eligible for employer contributions, and the length of time it will take for participants to be fully vested in their employer contributions. In addition, they may choose to automatically enroll participants.

Chapter 3 analyzes fees paid to operate ERISA 403(b) plans. BrightScope has built a total plan cost measure for plans with sufficiently complete information. Because participants and assets tend to be concentrated in larger plans, BrightScope’s total plan cost measure is analyzed for the average participant and the average dollar, as well as for the average plan. Then, because investment fees tend to be a significant portion of plan expenses and extensive information on mutual fund fees is available, the expense ratios of mutual funds in ERISA 403(b) plans are presented, with a special focus on the variation in mutual fund fees across plan size and different investment objectives (e.g., equity funds, balanced funds, bond funds, money market funds, and other funds).

## EXHIBIT I.6

**Audited ERISA 403(b) Plans and the Universe of ERISA 403(b) Plans by Number of Plan Participants***Distribution of 403(b) plans, participants, and assets by number of plan participants (2012)*

<b>Audited 403(b) filings</b>			
<b>Number of plan participants</b>	<b>Plans</b>	<b>Participants Thousands</b>	<b>Assets Billions of dollars</b>
Fewer than 100	294	19.2	\$2.7
100 to 499	2,272	548.8	33.2
500 to 999	538	377.5	25.9
1,000 to 4,999	617	1,330.4	76.6
5,000 to 9,999	118	829.4	49.8
10,000 or more	85	1,622.7	82.6
All plans	3,924	4,727.9	270.7

<b>Department of Labor 403(b) universe</b>			
<b>Number of plan participants</b>	<b>Plans</b>	<b>Participants Thousands</b>	<b>Assets Billions of dollars</b>
Fewer than 100	15,849	472.0	\$17.3
100 to 499	4,816	1,042.7	47.6
500 to 999	811	560.5	30.6
1,000 to 4,999	762	1,599.9	84.0
5,000 to 9,999	126	886.4	51.3
10,000 or more	88	1,698.2	84.2
All plans	22,452	6,259.6	314.9

<b>Audited 403(b) filings as a share of Department of Labor 403(b) universe</b>			
<b>Number of plan participants</b>	<b>Plans Percent</b>	<b>Participants Percent</b>	<b>Assets Percent</b>
Fewer than 100	1.9%	4.1%	15.6%
100 to 499	47.2	52.6	69.7
500 to 999	66.3	67.3	84.6
1,000 to 4,999	81.0	83.2	91.2
5,000 to 9,999	93.7	93.6	97.2
10,000 or more	96.6	95.6	98.1
All plans	17.5	75.5	86.0

Note: Audited 403(b) filings generally include plans with 100 participants or more. Components may not add to the total because of rounding.

Source: BrightScope Defined Contribution Plan Database





## CHAPTER 1

# ERISA 403(b) Plan Investment Menu Design

Employers in the nonprofit sector choose whether or not to offer 403(b) plans to their employees, and if so, how to design their plans to attract and retain qualified workers.<sup>14</sup> These design choices include the number and types of investment options in the plan, whether to contribute to the plan and whether to incentivize employees to contribute by matching their contributions, and whether and how to automatically enroll new employees into the plan. This chapter explores the investment menus that employers have chosen for 403(b) plans and how investments vary by plan size in the BrightScope Defined Contribution Plan Database.

### Number and Types of Investment Options

Historically, the investment menus of 403(b) plans have included multiple providers, each offering their full complements of mutual funds or annuity products. As regulations have changed to impose a stronger plan structure and to encourage plan sponsors to take more responsibility in selecting an appropriate investment lineup,<sup>15</sup> the number of investment options on the core menu has declined. Brokerage windows providing access to mutual funds and annuity products may still be offered, in some cases to keep legacy investment options available while providing a simpler choice structure for participants. To reflect this evolution, this chapter will primarily focus on what appear to be core offerings in ERISA 403(b) plans.

Analysis of all investments held in ERISA 403(b) plans in the BrightScope Defined Contribution Plan Database finds that participants had 41 investment options, on average, in 2012 (Exhibit 1.1). Larger ERISA 403(b) plans tended to offer more investment options, on average, than smaller plans. For example, among plans with less than \$1 million in plan assets,

the average number of investments offered was 21; that rose to 137 investment options for plans with more than \$1 billion in plan assets. Because plans may offer suites of target date funds with options tailored to multiple anticipated retirement dates, this paper also includes an adjusted number that counts a suite of target date funds as one investment option. On average, ERISA 403(b) plans offered 35 options according to this target date fund-adjusted number, ranging from 19 investment options for plans with less than \$1 million in plan assets to 117 investment options for plans with more than \$1 billion in plan assets. Many of these investment options in 403(b) plans hold a small share of total plan assets.

Historically, 403(b) plans have tended to have large lists of investment options, often including multiple providers' platforms. As regulations governing 403(b) plans changed, curated lists of investment options have become more common. Legacy options may present a skewed picture of the investment options that participants have to choose from. To correct for this, this report primarily focuses on core investment options, those that hold at least 0.5 percent of total plan assets. The average number of core investment options was 23 among ERISA 403(b) plans in 2012 (Exhibit 1.2). Just as with all investment options, larger ERISA 403(b) plans tended to offer more core investment options. For example, the average number of core investment options offered by plans with less than \$1 million in plan assets was 16, compared with 42 core investment options among plans with more than \$1 billion. Counting a suite of target date funds as one investment option, ERISA 403(b) plans offered 17 core investment options, on average, in 2012.

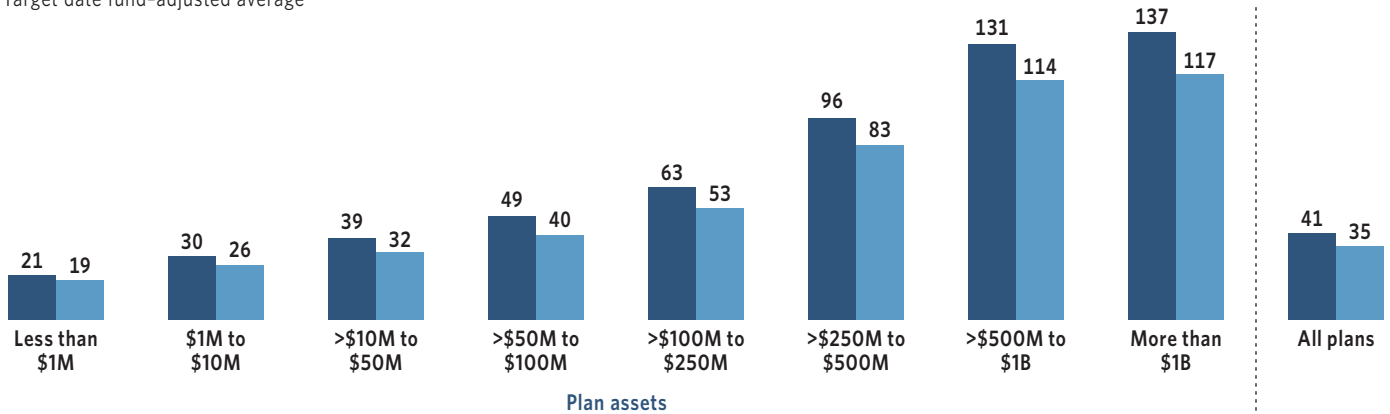
EXHIBIT 1.1

**Number of Investment Options in ERISA 403(b) Plans**

Average number of investment options among plans with audited 403(b) filings in the BrightScope database by plan assets, 2012

**Number of investment options**

■ Average  
■ Target date fund-adjusted average\*



\* This measure counts an entire suite of target date funds as one investment option for plans offering target date funds. A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name. A suite will cover a range of anticipated retirement dates.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. In this exhibit, all investments held in a plan are counted.

Source: BrightScope Defined Contribution Plan Database

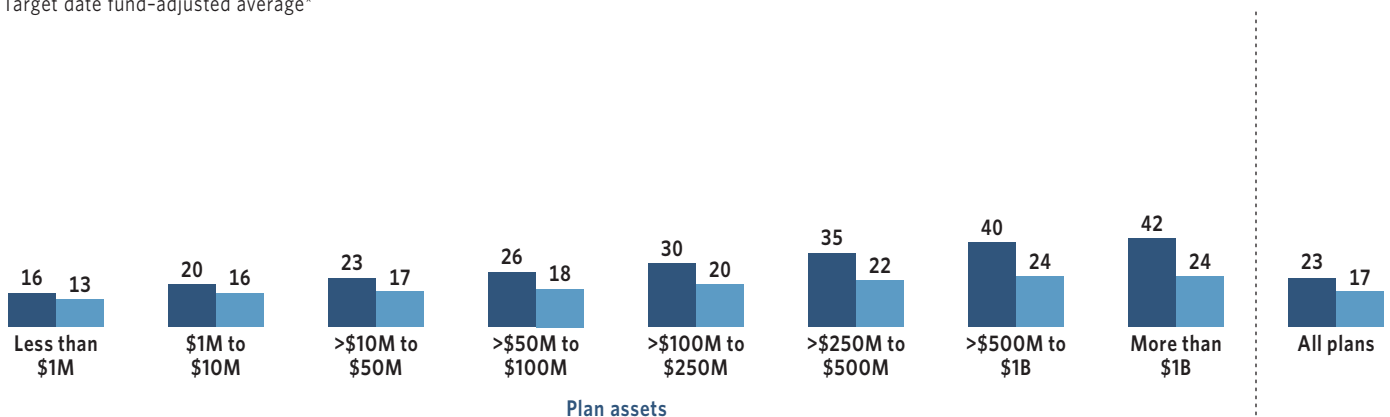
EXHIBIT 1.2

**Number of Core Investment Options in ERISA 403(b) Plans**

Average number of core investment options among plans with audited 403(b) filings in the BrightScope database by plan assets, 2012

**Number of core investment options**

■ Average  
■ Target date fund-adjusted average\*



\* This measure counts an entire suite of target date funds as one investment option for plans offering target date funds. A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name. A suite will cover a range of anticipated retirement dates.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. Core investment options are those that have at least 0.5 percent of plan assets. The funds in a target date fund suite are included if at least 0.5 percent of plan assets are invested in that suite.

Source: BrightScope Defined Contribution Plan Database

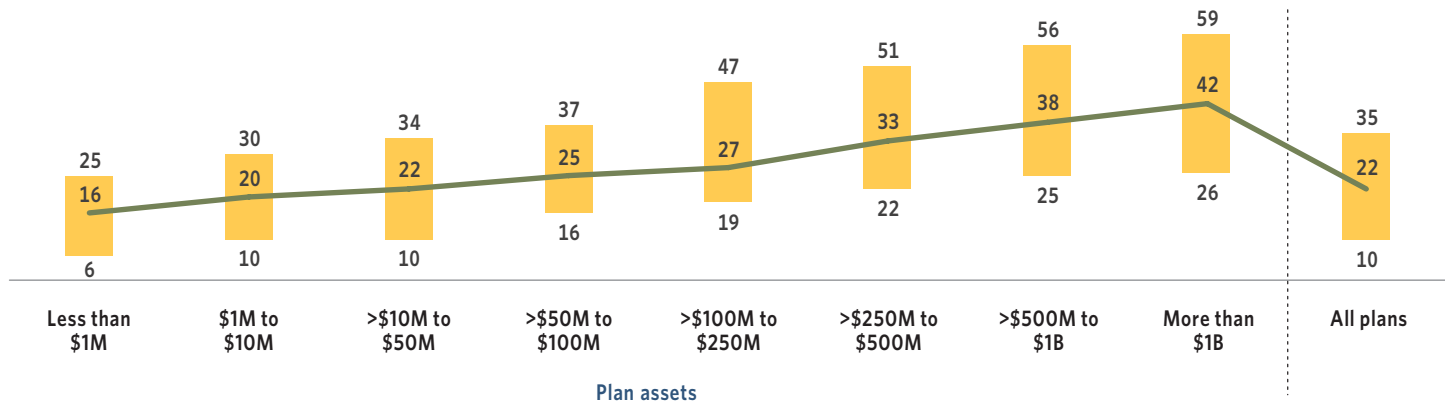
In addition to the variation in number of core investments offered by plan size, there is considerable variation between plans. For example, 10 percent of ERISA 403(b) plans offer 10 or fewer core investment options and plans at the 90th percentile offer 35 core options or more (Exhibit 1.3, upper panel). Plans

show considerable variability even with a target date fund-adjusted measure, ranging from 10 core options to 27 core options at the 10th and 90th percentiles (Exhibit 1.3, lower panel).

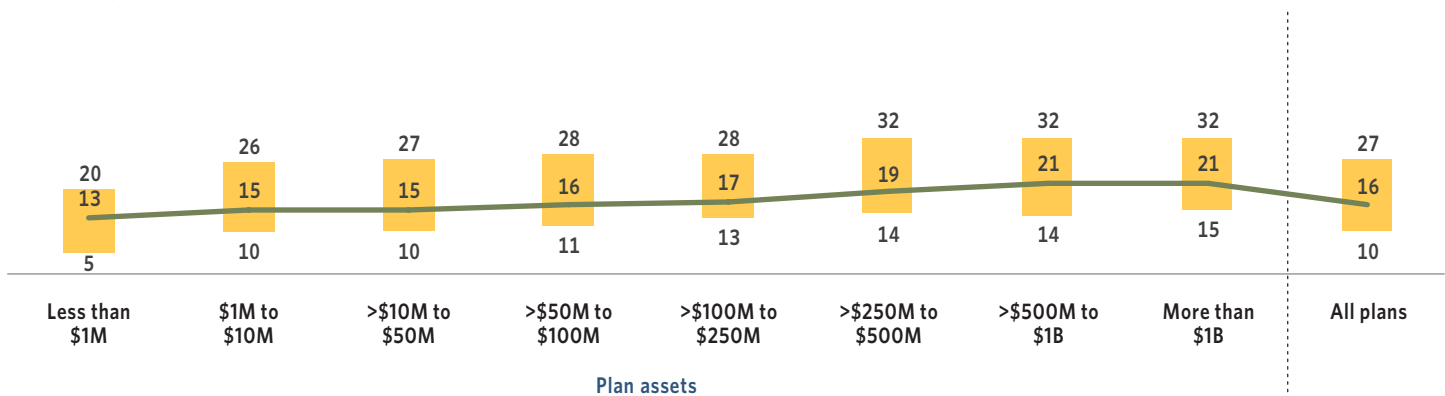
EXHIBIT 1.3

**Distribution of Core Investment Options in ERISA 403(b) Plans**

10th percentile, median, and 90th percentile number of core investment options among plans with audited 403(b) filings in the BrightScope database by plan assets (2012)



10th percentile, median, and 90th percentile number of target date fund-adjusted\* core investment options among plans with audited 403(b) filings in the BrightScope database by plan assets (2012)



\* This measure counts an entire suite of target date funds as one investment option for plans offering target date funds. A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name. A suite will cover a range of anticipated retirement dates.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. Core investment options are those that have at least 0.5 percent of plan assets. The funds in a target date fund suite are included if at least 0.5 percent of plan assets are invested in that suite.

Source: BrightScope Defined Contribution Plan Database

Domestic equity funds, international equity funds, and domestic bond funds were the most likely core investment options to be offered in ERISA 403(b) plans in 2012. Nearly all plans offered these types of funds, which can be mutual funds or variable annuities (Exhibit 1.4). In addition, about nine in 10 plans offered money funds in their core investment lineups. Nearly eight in 10 plans offered non-target date balanced funds, and more than two-thirds of plans offered target date funds in their core investment lineups. Eighty-four percent of plans offered fixed annuities, and 65 percent of ERISA 403(b) plans had other core investments. Fewer than 10 percent of ERISA 403(b) plans had international bond funds in their core investment lineups.

Most core investment types showed little variation in their availability by plan size. However, larger ERISA 403(b) plans were more likely to offer other investments, fixed annuities, or target date funds in their core investment lineups. For example, 31.7 percent of the smallest ERISA 403(b) plans offered other investments in their core investment lineups, compared with 95.0 percent of the largest plans (Exhibit 1.4). Similarly, 64.8 percent of plans with less than \$1 million in plan assets offered fixed annuities in 2012, compared with more than 90 percent of plans with more than \$10 million.

#### EXHIBIT 1.4

### Equity and Bond Funds Are the Most Common Core Investment Options in ERISA 403(b) Plans

Percentage of plans with audited 403(b) filings in the BrightScope database offering the specified core investment option by plan assets, 2012

Plan assets	Equity funds		Balanced funds		Bond funds		Money funds	Fixed annuities	Other <sup>2</sup>	Memo: index funds
	Domestic	International	Target date funds <sup>1</sup>	Non-target date balanced funds	Domestic	International				
Less than \$1M	93.8	81.1	52.7	81.5	94.7	13.2	64.6	64.8	31.7	56.4
\$1M to \$10M	97.4	93.4	61.6	79.8	99.2	10.1	86.3	77.8	48.7	80.6
>\$10M to \$50M	99.8	99.0	68.7	70.2	99.8	9.0	95.3	90.5	79.1	96.8
>\$50M to \$100M	99.5	99.2	79.4	85.6	99.7	9.2	96.2	92.1	77.0	97.6
>\$100M to \$250M	99.7	99.0	83.9	92.3	99.7	5.8	98.4	92.9	82.3	98.7
>\$250M to \$500M	100.0	100.0	89.7	94.0	100.0	11.1	99.1	91.5	84.6	100.0
>\$500M to \$1B	100.0	100.0	94.9	91.5	100.0	6.8	98.3	91.5	81.4	100.0
More than \$1B	100.0	97.5	97.5	97.5	97.5	7.5	97.5	95.0	95.0	97.5
All plans	98.5	95.8	68.5	79.1	99.3	9.5	90.5	84.4	64.8	88.5

<sup>1</sup> A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

<sup>2</sup> Other includes commodity funds, real estate funds, and brokerage accounts.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Participant loans are excluded. Funds include mutual funds and variable annuities. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. Core investment options are those that have at least 0.5 percent of plan assets. The funds in a target date fund suite are included if at least 0.5 percent of plan assets are invested in that suite.

Source: BrightScope Defined Contribution Plan Database

Equity funds were the most common core investment option in 2012, with ERISA 403(b) plans offering 9.8 funds on average, of which 7.7 were domestic equity funds and 2.1 were international equity funds (Exhibit 1.5). Larger plans tended to offer more core equity funds—plans with less than \$1 million in plan assets offered 7.4 core equity funds compared with 13.4 offered by plans with more than \$500 million to \$1 billion in plan assets, and 12.7 offered by plans with more than \$1 billion in plan assets.

The next most common category in ERISA 403(b) core investment lineups in 2012 was balanced funds, with 7.8 funds offered on average, most of which (6.7 funds) were target date funds (Exhibit 1.5). Larger 403(b) plans tended to have more core target date funds for two reasons. First, larger plans tended to be more likely to offer core target date funds (Exhibit 1.4). Second, larger plans offered more funds as part of their core target date fund suites on average. For example,

among ERISA 403(b) plans with more than \$1 billion in plan assets, the average core target date fund suite included around 11 funds (20.3 target date funds divided by 1.9 target date fund suites) (Exhibit 1.5). For plans with less than \$1 million in plan assets, the average core target date fund suite included around six funds (3.4 target date funds divided by 0.6 target date fund suites). On average, there were about eight target date funds (6.7 target date funds divided by 0.8 target date fund suites) in a core suite across all plans in the sample.

In 2012, ERISA 403(b) plans included 2.5 bond funds (mostly domestic) in their core investment lineups, on average (Exhibit 1.5). Plans also offered core money funds, fixed annuities, and other options. These investments were often included as the single choice in that investment type. Larger plans tended to be somewhat more likely to offer these options in their core lineups (Exhibit 1.4).

## EXHIBIT 1.5

### Average Number of Core Investment Options by Type of Investment in ERISA 403(b) Plans

Average number of core investment options among plans with audited 403(b) filings in the BrightScope database by plan assets, 2012

Plan assets	Average number of investment options										Memo:	
	Equity funds		Balanced funds		Bond funds			Money funds	Fixed annuities	Other <sup>2</sup>	Index funds	Adjusted target date fund <sup>3</sup>
	Domestic	International	Target date funds <sup>1</sup>	Non-target date balanced funds	Domestic	International						
Less than \$1M	5.6	1.8	3.4	1.4	1.6	0.1	0.8	0.8	0.4	1.6	0.6	
\$1M to \$10M	7.4	2.1	4.4	1.5	2.2	0.1	1.1	1.0	0.5	2.5	0.7	
>\$10M to \$50M	7.5	2.0	6.7	0.7	2.5	0.1	1.3	1.2	0.9	3.1	0.8	
>\$50M to \$100M	8.4	2.3	8.9	0.8	2.5	0.1	1.3	1.3	0.9	3.3	1.0	
>\$100M to \$250M	8.9	2.4	11.3	0.9	2.7	0.1	1.4	1.4	1.0	4.3	1.2	
>\$250M to \$500M	9.6	2.5	14.5	1.0	3.1	0.1	1.7	1.4	1.1	5.6	1.4	
>\$500M to \$1B	10.7	2.7	17.9	1.3	3.5	0.1	1.7	1.2	1.1	6.0	1.6	
More than \$1B	10.2	2.5	20.3	1.1	3.4	0.1	1.8	1.5	1.3	8.2	1.9	
All plans	7.7	2.1	6.7	1.1	2.4	0.1	1.2	1.1	0.7	3.1	0.8	

<sup>1</sup> A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

<sup>2</sup> Other includes commodity funds, real estate funds, and brokerage accounts, but each separate option is counted as a unique investment option.

<sup>3</sup> This measure counts an entire suite of target date funds as one investment option for plans offering target date funds.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Participant loans are excluded. Funds include mutual funds and variable annuities. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. Core investment options are those that have at least 0.5 percent of plan assets. The funds in a target date fund suite are included if at least 0.5 percent of plan assets are invested in that suite. Exhibit A.1 in the appendix shows the average number of a given core investment option offered by plans that have at least one of that investment option.

Source: BrightScope Defined Contribution Plan Database

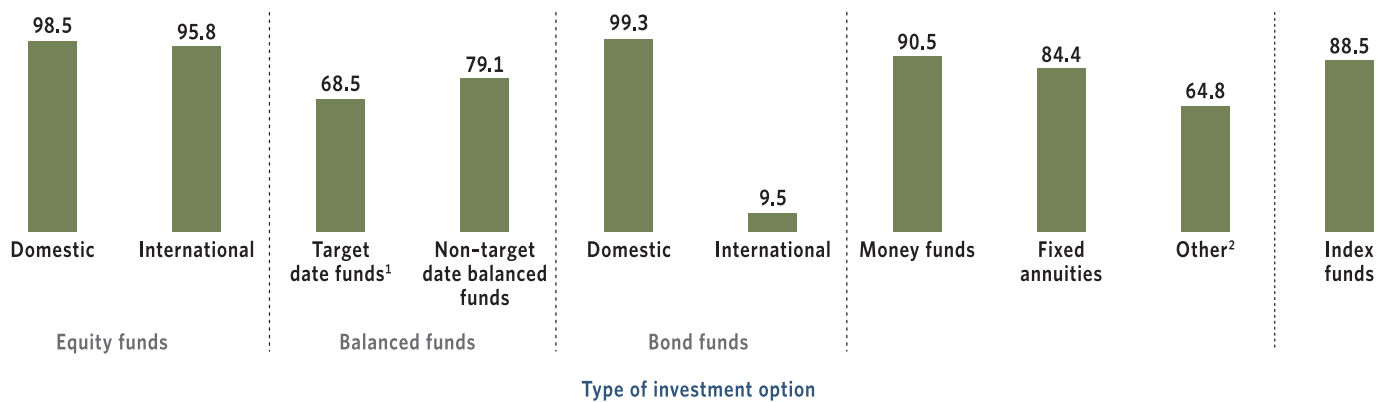
It is instructive to consider availability and then the number of core investment options by investment category contingent on that investment category being offered in the 403(b) plan's core lineup. For example, domestic equity funds are not only widely available, with 98.5 percent of ERISA 403(b) plans including them in their core investment lineups in 2012 (Exhibit 1.6, upper panel), but also, when they are an option, multiple domestic equity funds—7.8 on average—are offered (Exhibit 1.6, lower panel).

International equity funds also are widely available, offered in 95.8 percent of ERISA 403(b) plan core lineups in 2012, but on average, 2.2 international equity funds are offered in ERISA 403(b) plans including that investment type (Exhibit 1.6). Similarly, domestic bond funds are widely available, offered in 99.3 percent of ERISA 403(b) plan core lineups in 2012, but on average, 2.4 domestic bond funds are offered in ERISA 403(b) plans including that investment type. About 90 percent of ERISA 403(b) plans offer 1.3 core money funds on average, and 84.4 percent of ERISA 403(b) plans offer 1.3 core fixed annuities on average. Nearly nine in 10 ERISA 403(b) plans in 2012 had index funds in their core investment lineups, offering 3.5 funds on average.

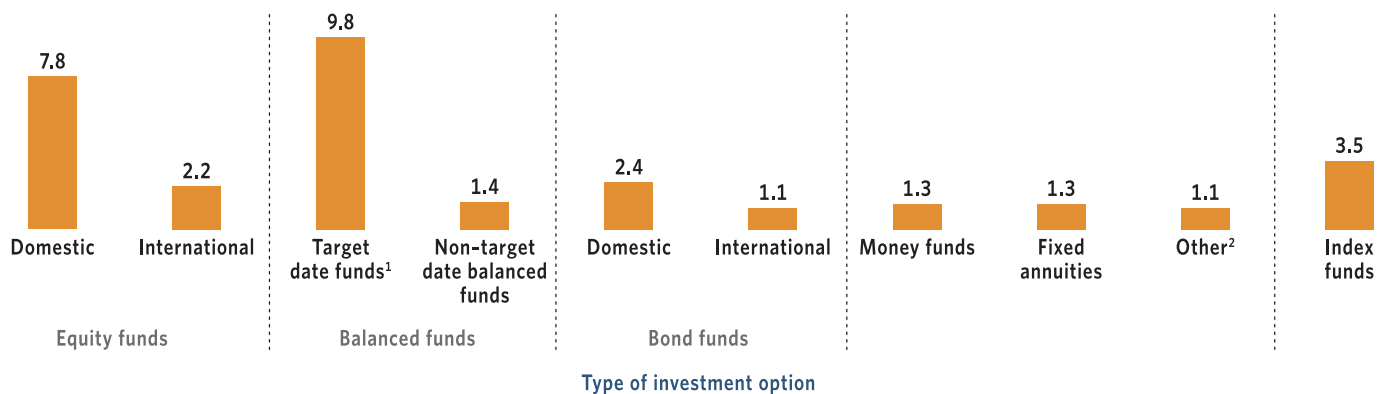
EXHIBIT 1.6

### Incidence and Number of Core Investment Options Offered by Type of Investment in ERISA 403(b) Plans

Percentage of plans with audited 403(b) filings in the BrightScope database offering the specified core investment option, 2012



Average number of core investment options among plans offering a given core investment option, 2012



<sup>1</sup> A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

<sup>2</sup> Other includes commodity funds, real estate funds, and brokerage accounts, but each separate option is counted as a unique investment option.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Participant loans are excluded. Funds include mutual funds and variable annuities. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. Core investment options are those that have at least 0.5 percent of plan assets. The funds in a target date fund suite are included if at least 0.5 percent of plan assets are invested in that suite. Exhibit A.1 in the appendix shows the average number of a given core investment option offered by plans that have at least one of that investment option.

Source: BrightScope Defined Contribution Plan Database

## Investment Vehicles

When choosing which investment options to offer, employers also choose the investment vehicles (for example, mutual funds, variable annuities, or fixed annuities) for these options. Mutual funds were the most common investment vehicle in ERISA 403(b) plans in the BrightScope database, representing 47 percent of assets in 2012 (Exhibit 1.7). Mutual funds were a slightly larger share of assets in the smallest ERISA 403(b) plans, accounting for 56 percent of assets in plans with less than \$1 million in plan assets. Overall, variable annuities held an additional 27 percent of assets, followed by fixed annuities with 26 percent.

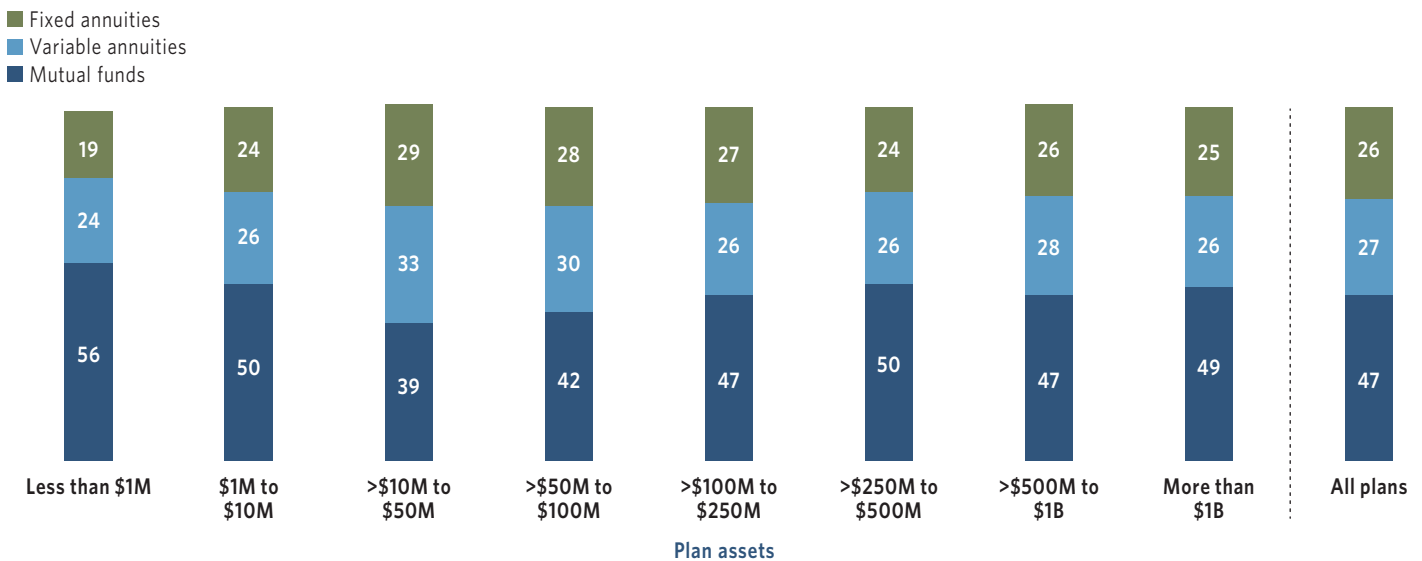
## Aggregate Asset Allocation

Although employers choose the investment options offered in 403(b) plans, participants generally choose where to allocate the money in their accounts among such options. In 2012, equity funds held the largest share (43.1 percent) of ERISA 403(b) assets in the BrightScope database, with the bulk invested in domestic equity funds (Exhibit 1.8). Fixed annuities held the next largest share with 26.2 percent of ERISA 403(b) plan assets. Balanced funds followed, with 15.2 percent of assets—which were divided between target date funds (12.3 percent of assets) and non-target date balanced funds (2.9 percent of assets). Bond funds (mostly domestic)

EXHIBIT 1.7

### Types of Investment Vehicles in ERISA 403(b) Plans

Percentage of total assets among plans with audited 403(b) filings in the BrightScope database by plan assets, 2012



Note: The sample is 3,924 plans with \$270.7 billion in assets. Participant loans are excluded. Audited 403(b) filings generally include plans with 100 participants or more. Variable annuities include variable annuity mutual funds. Components may not add to 100 percent because of rounding.

Source: BrightScope Defined Contribution Plan Database

## EXHIBIT 1.8

**The Largest Share of ERISA 403(b) Plan Assets Is Invested in Equity Funds**

Percentage of total assets among plans with audited 403(b) filings in the BrightScope database by plan assets or number of plan participants, 2012

Plan assets	Equity funds		Balanced funds		Bond funds		Money funds	Fixed annuities	Other <sup>2</sup>	Memo: index funds
	Domestic	International	Target date funds <sup>1</sup>	Non-target date balanced funds	Domestic	International				
Less than \$1M	26.3	9.0	17.7	10.5	8.0	0.5	5.6	19.3	3.0	7.1
\$1M to \$10M	32.5	7.8	12.5	6.4	8.8	0.3	4.9	24.4	2.5	10.8
>\$10M to \$50M	37.0	6.9	9.4	2.5	8.5	0.2	3.6	28.8	3.1	10.7
>\$50M to \$100M	36.4	6.8	10.6	2.9	8.8	0.2	3.4	28.1	2.9	10.4
>\$100M to \$250M	35.8	6.5	12.6	2.8	8.5	0.1	3.9	26.7	3.1	12.3
>\$250M to \$500M	37.4	6.5	14.0	2.5	8.5	0.2	3.8	24.4	2.8	13.2
>\$500M to \$1B	35.7	5.8	13.9	3.0	8.4	0.1	4.1	25.9	2.9	12.2
More than \$1B	38.3	5.4	12.3	3.1	7.6	0.2	3.8	25.4	4.0	18.6
All plans	36.9	6.2	12.3	2.9	8.3	0.2	3.8	26.2	3.3	13.9

Number of plan participants	Equity funds		Balanced funds		Bond funds		Money funds	Fixed annuities	Other <sup>2</sup>	Memo: index funds
	Domestic	International	Target date funds <sup>1</sup>	Non-target date balanced funds	Domestic	International				
Fewer than 100	38.6	6.5	5.0	1.8	8.1	0.1	3.3	32.7	3.9	10.8
100 to 499	38.3	6.3	6.5	1.9	8.0	0.1	3.4	32.1	3.3	8.8
500 to 999	37.3	5.9	8.4	1.9	7.5	0.1	3.0	32.3	3.5	9.8
1,000 to 4,999	35.8	6.5	11.0	3.1	8.6	0.2	3.6	28.0	3.2	12.3
5,000 to 9,999	37.9	6.1	12.7	3.4	8.5	0.2	4.4	24.3	2.5	13.5
10,000 or more	36.4	5.9	17.2	3.3	8.2	0.2	4.0	21.0	3.7	18.9
All plans	36.9	6.2	12.3	2.9	8.3	0.2	3.8	26.2	3.3	13.9

<sup>1</sup> A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

<sup>2</sup> Other includes commodity funds, real estate funds, and brokerage accounts.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Participant loans are excluded. Funds include mutual funds and variable annuities. Audited 403(b) filings generally include plans with 100 participants or more. Row percentages may not add to 100 percent because of rounding.

Source: BrightScope Defined Contribution Plan Database



held 8.5 percent of assets, and money funds held 3.8 percent. Participants in larger plans (as measured by plan assets) tended to have less of their assets invested in target date funds, non-target date balanced funds, and money funds. For example, participants in ERISA 403(b) plans with less than \$1 million in plan assets had 28.2 percent of their assets invested in balanced funds and 5.6 percent in money funds, on average, compared with 15.4 percent and 3.8 percent, respectively, for participants in plans with more than \$1 billion in plan assets. However, participants in these larger ERISA 403(b) plans tended to have more of their money invested in fixed annuities and domestic equity funds. For example, in 2012, participants in plans with less than \$1 million in plan assets invested 19.3 percent of their assets in fixed annuities and 26.3 percent in domestic equity funds, compared with 25.4 percent in fixed annuities and 38.3 percent in domestic equity funds for plans with more than \$1 billion in plan assets.

Over time, ERISA 403(b) plans have become more likely to offer target date funds. In 2012, 68.5 percent of ERISA 403(b) plans offered target date funds in their core investment lineups, compared with 51.4 percent in 2009 (Exhibit 1.9, upper panel). The share of participants who were offered target date funds increased to 79.5 percent in 2012, from 71.0 percent in 2009 (Exhibit 1.9, middle panel). The share of plan assets invested in these funds also increased, rising to 12.3 percent in 2012 from 6.7 percent in 2009 (Exhibit 1.9, lower panel).

## Index Funds

Index funds, which are funds that track a market index (e.g., S&P 500 funds), generally claimed a greater share of assets in larger ERISA 403(b) plans than in smaller plans. On average, 13.9 percent of 403(b) assets in the BrightScope database were invested in index funds in 2012, but this fraction ranged from 7.1 percent of assets in plans with less than \$1 million in plan assets to 18.6 percent in plans with more than \$1 billion (Exhibit 1.8, upper panel). Similarly, 10.8 percent of assets in ERISA 403(b) plans with fewer than 100 participants were invested in index funds, compared with 18.9 percent of assets in plans with 10,000 participants or more (Exhibit 1.8, lower panel).

The share of ERISA 403(b) plan assets invested in index funds has risen since 2009. In 2009, 9.9 percent of 403(b) plan assets in the BrightScope database were invested in index funds (Exhibit 1.10, lower panel). This rose to 13.9 percent in 2012. Although index funds were offered nearly universally in ERISA 403(b) plans with more than \$10 million in assets in 2012, only 56.4 percent of plans with less than \$1 million in plan assets offered them (Exhibit 1.10, upper panel).

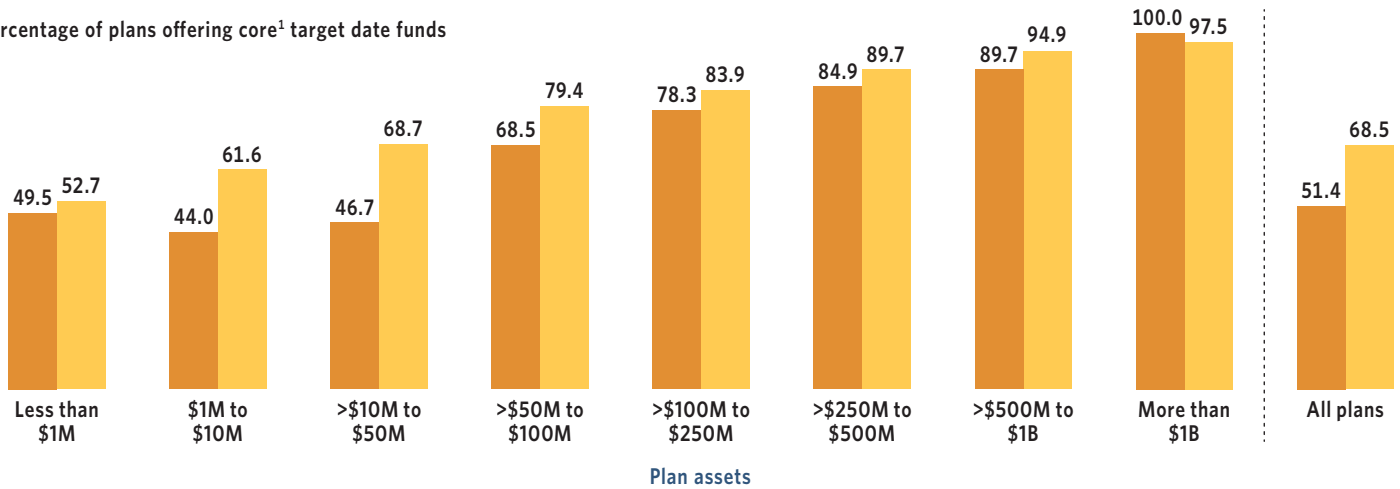
EXHIBIT 1.9

**Core Target Date Fund Use Generally Has Risen over Time in ERISA 403(b) Plans**

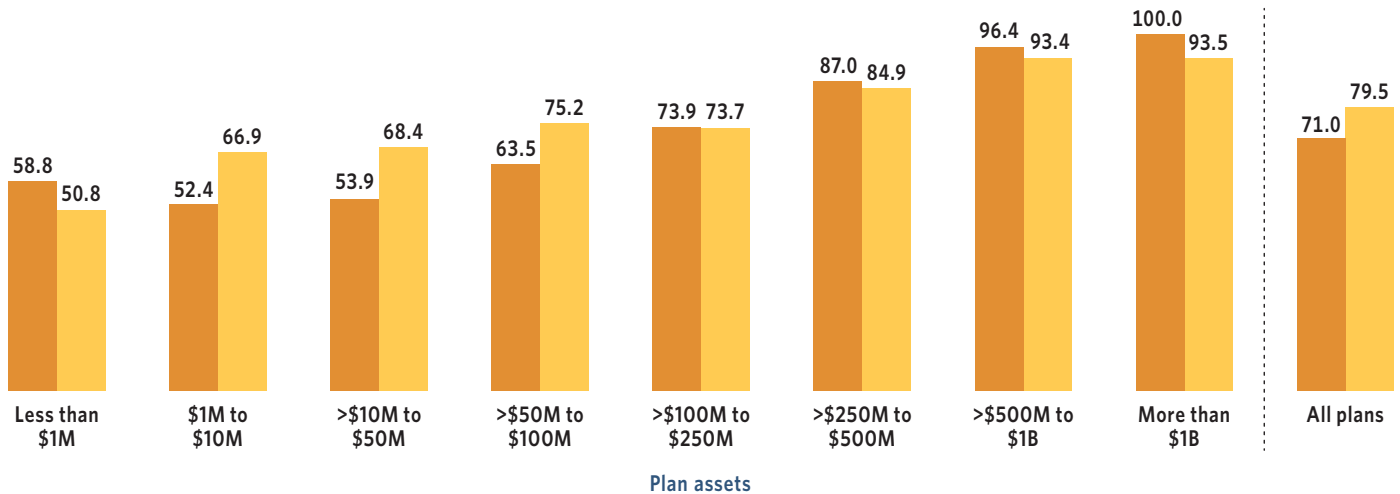
Percentage of plans offering, participants offered, and plan assets in target date funds\* among plans with audited 403(b) filings in the BrightScope database by plan assets (2009 and 2012)

2009  
2012

Percentage of plans offering core<sup>1</sup> target date funds



Percentage of participants who were offered core<sup>1</sup> target date funds



Percentage of plan assets in target date funds<sup>2</sup>



<sup>1</sup> Core target date funds are target date funds included in a suite of funds which holds at least 0.5 percent of plan assets.

<sup>2</sup> In the calculation of target date fund assets, all target date funds in the plan are counted.

Note: Samples are 3,196 plans in 2009 and 3,924 plans in 2012. Audited 403(b) filings generally include plans with 100 participants or more. A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name. Funds include mutual funds and variable annuities.

Source: BrightScope Defined Contribution Plan Database

## EXHIBIT 1.10

**Core Index Fund Use in ERISA 403(b) Plans**

Percentage of plans offering, and plan assets in, index funds among plans with audited 403(b) filings in the BrightScope database by plan assets, 2009 and 2012

Plan assets	Percentage of plans offering core <sup>1</sup> index funds	
	2009	2012
Less than \$1M	72.3	56.4
\$1M to \$10M	83.1	80.6
>\$10M to \$50M	95.5	96.8
>\$50M to \$100M	98.1	97.6
>\$100M to \$250M	98.7	98.7
>\$250M to \$500M	100.0	100.0
>\$500M to \$1B	100.0	100.0
More than \$1B	100.0	97.5
All plans	89.6	88.5

Plan assets	Percentage of plan assets in index funds <sup>2</sup>	
	2009	2012
Less than \$1M	9.2	7.1
\$1M to \$10M	9.5	10.8
>\$10M to \$50M	8.2	10.7
>\$50M to \$100M	8.7	10.4
>\$100M to \$250M	9.1	12.3
>\$250M to \$500M	10.4	13.2
>\$500M to \$1B	8.6	12.2
More than \$1B	13.2	18.6
All plans	9.9	13.9

<sup>1</sup> Core index funds are index funds that have at least 0.5 percent of plan assets.

<sup>2</sup> In the calculation of index fund assets, all index funds in the plan are counted.

Note: Samples are 3,196 plans in 2009 and 3,924 plans in 2012. Audited 403(b) filings generally include plans with 100 participants or more. An index fund is designed to track the performance of a market index. The fund's portfolio of securities is either a replicate or a representative sample of the designated market index. Funds include mutual funds and variable annuities.

Source: BrightScope Defined Contribution Plan Database



## CHAPTER 2

# ERISA 403(b) Plan Employer Contribution and Enrollment Design

When designing their 403(b) plans, in addition to choosing investment options, employers also decide how contributions to the plan will be structured. Employers can make contributions to 403(b) plans either without regard to employee contributions or by using a matching structure that incentivizes employees to contribute to the plan. They also determine when participants will be eligible for employer contributions and when they will vest in those contributions, and can automatically enroll employees into the plan at a given contribution rate to encourage participation.

### The Role of Employer Contributions in ERISA 403(b) Plans

Employers choose whether, how, and how much to contribute to their employees' 403(b) accounts. They could make a fixed contribution (whether a fixed dollar amount or a fixed percentage of salary) to each employee's account regardless of the employee's contributions (nonelective contributions); match some percentage of employee contributions up to a fixed dollar amount or up to a fixed percentage of salary; implement a more complicated tiered matching formula in which employee contributions are matched at different rates depending on how much the employee contributes; or choose not to contribute to the plan at all. ERISA 403(b) plans are subject to nondiscrimination rules to ensure that the contributions do not disproportionately accrue to highly compensated employees, but otherwise employers can choose how to structure their contributions, within contribution limits set by the Internal Revenue Code.<sup>16</sup> DOL Form 5500 data indicate that in 2012 employers made contributions to their employees' accounts in almost four-fifths of ERISA 403(b) plans with 100 participants or more (Exhibit 2.1).<sup>17</sup>

Medium-sized ERISA 403(b) plans were slightly more likely to have employer contributions. Eighty-two percent of ERISA 403(b) plans with more than \$10 million to \$100 million in

plan assets had employer contributions in 2012 compared with 75 percent of plans with \$10 million or less in plan assets and 78 percent of plans with more than \$100 million (Exhibit 2.1). The share of ERISA 403(b) plans making employer contributions has increased since 2009 for plan sponsors of all asset sizes.

### Types of Employer Contributions

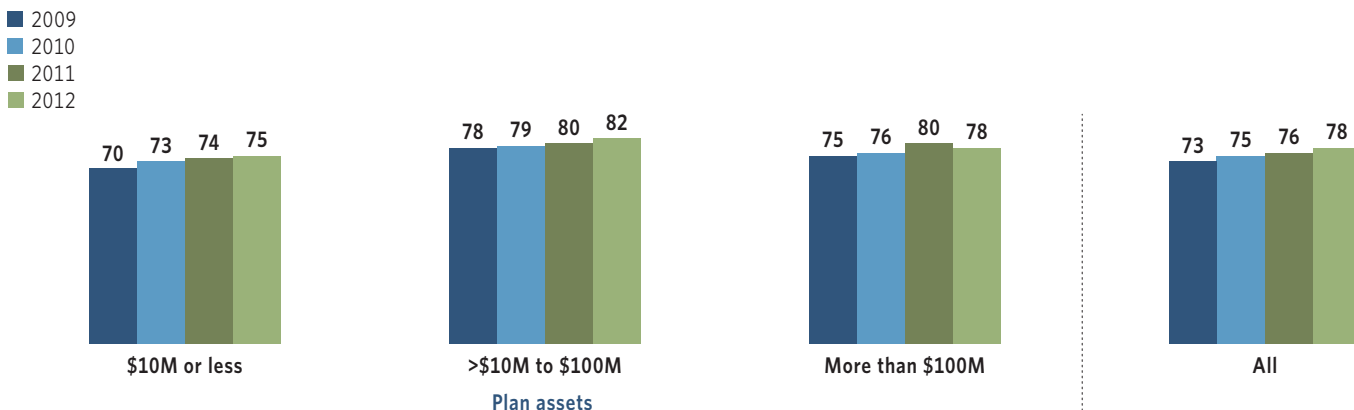
Employers choosing to make contributions to their employees' 403(b) plan accounts can choose either to match contributions made by the employees or to make contributions regardless of employee contributions. If the employer chooses to match employee contributions, the employer can choose a simple match formula, a tiered match formula, or a maximum dollar match formula. With a simple match formula, employee contributions are matched up to a fixed percentage of salary (for example, the employer matches 50 percent of employee contributions for the first 6 percent of the employee's salary, for a maximum employer contribution of 3 percent of the employee's salary). With a tiered match formula, different levels of employee contributions are matched at different rates (for example, matching 100 percent of the first 4 percent of salary contributed and 50 percent of the next 2 percent, for a maximum employer contribution of 5 percent of the employee's salary). With a maximum dollar match formula, employee contributions are matched up to a given dollar threshold (for example, matching 50 percent of the first \$2,000 in contributions, for a maximum employer contribution of \$1,000).

In 2012, 31 percent of ERISA 403(b) plans in the BrightScope database had a simple match formula, 1 percent had a tiered match formula, and 1 percent matched employee contributions up to a maximum dollar amount (Exhibit 2.2). Forty-six percent of ERISA 403(b) plans contributed money to the plan without regard to how much the employee contributed.<sup>18</sup> Participants in the final 22 percent of ERISA 403(b) plans did not receive any employer contributions in 2012.

EXHIBIT 2.1

**Employers Make Contributions in Majority of ERISA 403(b) Plans**

Percentage of ERISA 403(b) plans with 100 participants or more with employer contributions (by plan assets, plan year 2009–2012)

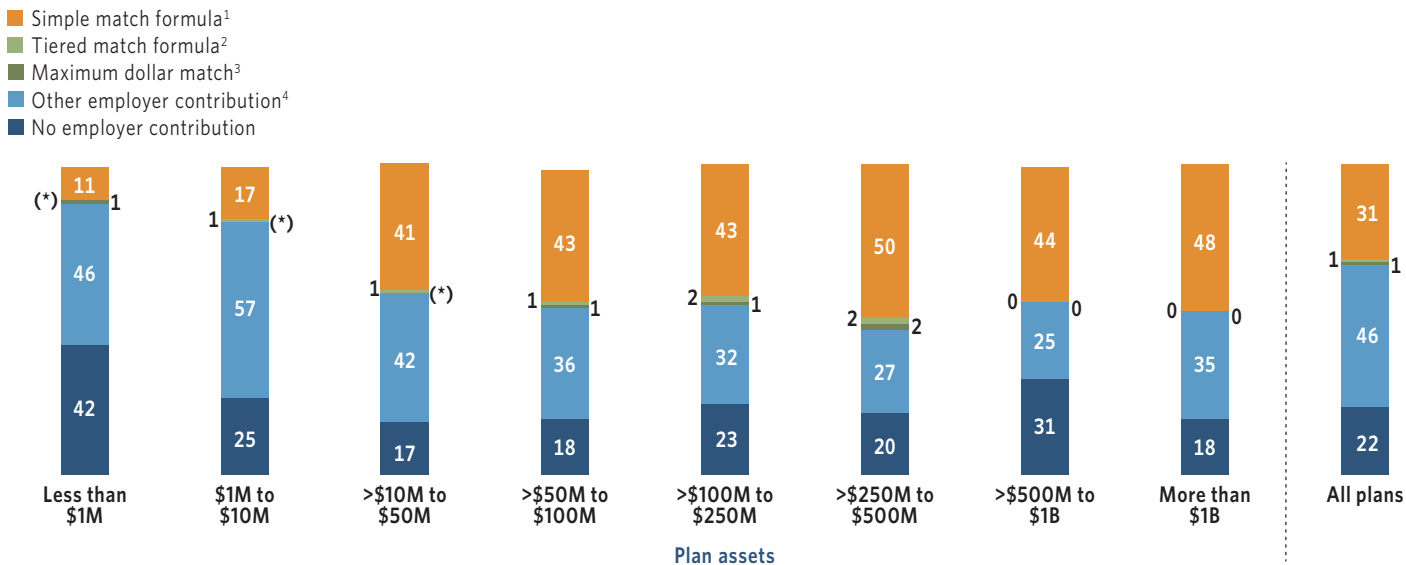


Note: The sample includes 403(b) plans with 100 participants or more.  
 Source: ICI tabulations of U.S. Department of Labor Form 5500 Research File

EXHIBIT 2.2

**Design of ERISA 403(b) Plan Employer Contributions**

Percentage of plans among plans with audited 403(b) filings in the BrightScope database by plan assets, 2012



<sup>1</sup> Simple match formulas are employer contributions of a specified percentage of employee contributions up to a fixed percentage of employee salary (for example, matching 50 percent of employee contributions up to 6 percent of the employee’s salary).  
<sup>2</sup> Tiered match formulas match employee contributions at different rates for different levels of employee contributions (for example, matching 100 percent of the first 4 percent of salary contributed and 50 percent of the next 2 percent).  
<sup>3</sup> Maximum dollar match formulas are employer contributions of some percentage of employee contributions up to a fixed dollar amount (for example, matching 50 percent of the first \$2,000 of employee contributions).  
<sup>4</sup> Other employer contributions include nonelective contributions and lump-sum contributions without an additional matching formula. Plans with employer matches but missing descriptions of the employer match data may be included in this category.  
 (\*) = less than 0.5 percent

Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more. Components may not add to 100 percent because of rounding.

Source: BrightScope Defined Contribution Plan Database

Simple match formulas were more common in midsize and larger ERISA 403(b) plans. Although only 11 percent of ERISA 403(b) plans with less than \$1 million in plan assets offered a simple match, more than 40 percent of plans with more than \$10 million in plan assets did so (Exhibit 2.2). The smallest ERISA 403(b) plans were also significantly less likely to have employer contributions: 42 percent of plans with less than \$1 million in plan assets had no employer contributions.

### Eligibility and Vesting

If employers offer matching contributions to employees, they can choose to impose a minimum service requirement before employees are eligible to receive the matching contributions. Employers also can choose to implement a

vesting schedule, where employees forfeit some or all of the employer contributions in their accounts if they leave the employer before a specified length of time. The most common combination of match eligibility and vesting for plans with matching contributions was for employees to receive matching contributions after a year of eligibility, but to be immediately vested in those contributions: 31.4 percent of ERISA 403(b) plans (Exhibit 2.3). Overall, employees in about two-thirds of ERISA 403(b) plans were immediately vested, and nearly half of plans made employees eligible for employer contributions after one year of eligibility. The next most common combination, in 17.9 percent of plans with matching contributions, was for employees to be immediately eligible for employer matching contributions and immediately vested in those contributions.

#### EXHIBIT 2.3

### Eligibility and Vesting in ERISA 403(b) Plans

*Years until fully vested by months until eligible for matching contribution among plans with audited 403(b) filings in the BrightScope database, percentage of plans (2012)*

Months until eligible for matching contribution	Years until fully vested							Total
	Zero	One	Two	Three	Four	Five	Six	
Immediate	17.9	0.6	2.1	5.6	0.4	2.4	0.7	29.7
>0 to <12	5.9	0.4	0.1	1.9	0.4	1.5	1.0	11.1
12	31.4	0.3	0.7	5.4	0.7	6.7	2.5	47.7
More than 12	11.2	0.1	0.2	0.1	0.0	0.0	0.0	11.6
Total	66.4	1.3	3.0	13.0	1.4	10.6	4.3	100.0

Note: The sample is 1,052 plans with matching contributions and information on eligibility and vesting. Audited 403(b) filings generally include plans with 100 participants or more. Row and column percentages may not add to the totals because of rounding.

Source: BrightScope Defined Contribution Plan Database

## Simple Match Formulas

For simple match formulas, the employer chooses the percentage of employee contributions to match, as well as the maximum contribution percentage to match. Among the 31 percent of ERISA 403(b) plans with simple match formulas in the BrightScope database, the most common formula was matching 100 percent of contributions up to 5 percent of employee salary, with 15.3 percent of ERISA 403(b) plans using this formula (Exhibit 2.4, upper panel). The next most common simple match formula was a 100 percent match of contributions up to 3 percent of employee salary, in 12.1 percent of ERISA 403(b) plans with simple match formulas. Altogether, 63.9 percent of ERISA 403(b) plans with simple match formulas matched 100 percent of employee contributions (with various

limits on the maximum employee contribution matched). The distribution of 403(b) participants across the match formulas differs from the distribution of 403(b) plans with each matching formula. The most common match formula for ERISA 403(b) participants was matching 50 percent of employee contributions up to 6 percent of pay, for 14.1 percent of 403(b) participants in plans with simple match formulas (Exhibit 2.4, lower panel). The second most common match formula was matching 50 percent of contributions up to 4 percent of pay, covering 12.1 percent of ERISA 403(b) participants. Overall, 46.6 percent of ERISA 403(b) participants in plans with simple match formulas were in plans matching 100 percent of employee contributions and 38.5 percent were in plans matching 50 percent of employee contributions (with various limits on the maximum employee contribution matched).

### EXHIBIT 2.4

#### Employers with Simple Matches Use a Variety of Matching Formulas in ERISA 403(b) Plans

Percentage of plans or participants among plans with simple match formulas from audited 403(b) filings in the BrightScope database, 2012

##### Percentage of plans

Percentage of deferral matched	Maximum deferral percentage matched								Total
	<3%	3%	4%	5%	6%	7%, 8%, or 9%	10% or more	Other	
25%	0.8	0.3	1.5	0.2	1.1	0.3	0.2	0.0	4.5
50%	3.9	2.5	6.9	1.6	5.8	1.0	0.8	0.0	22.6
75%	0.1	0.1	0.2	0.0	0.2	0.0	0.0	0.1	0.6
100%	10.2	12.1	5.8	15.3	6.3	7.1	3.7	3.2	63.9
Other	1.5	0.7	0.8	3.2	1.1	0.3	0.3	0.5	8.4
Total	16.6	15.7	15.3	20.3	14.4	8.8	5.0	3.8	100.0

##### Percentage of participants

Percentage of deferral matched	Maximum deferral percentage matched								Total
	<3%	3%	4%	5%	6%	7%, 8%, or 9%	10% or more	Other	
25%	1.0	0.4	2.3	(*)	1.1	0.2	0.5	0.0	5.6
50%	5.8	3.4	12.1	1.5	14.1	1.1	0.5	0.0	38.5
75%	(*)	(*)	0.4	0.0	(*)	0.0	0.0	(*)	0.4
100%	10.8	8.8	6.6	9.0	5.3	2.5	2.1	1.5	46.6
Other	5.0	0.4	0.7	2.0	0.5	0.2	0.1	0.1	8.9
Total	22.5	13.0	22.1	12.5	21.0	4.0	3.3	1.7	100.0

(\*) = less than 0.05 percent

Note: Plans with no employer contribution, maximum dollar contributions, tiered match formulas, or only a nonmatching contribution were excluded. The sample is the 31 percent of plans with simple match formulas (see Exhibit 2.2). Audited 403(b) filings generally include plans with 100 participants or more. Row and column percentages may not add to the totals because of rounding.

Source: BrightScope Defined Contribution Plan Database



## The Role of Automatic Enrollment in ERISA 403(b) Plans

Employers also can choose to automatically enroll employees in 403(b) plans, choosing a default initial contribution rate and a default investment, unless the employee indicates otherwise. The employee can then choose to opt out of the plan entirely, adjust the contribution rate or investment allocation, or leave the default options unchanged. In 2012, 8.3 percent of ERISA 403(b) plans in the BrightScope database auto-enrolled participants (Exhibit 2.5).<sup>19</sup> These plans covered 23.6 percent of participants and 19.9 percent of assets. Auto-enrollment rates varied by plan size, with larger ERISA 403(b) plans being more likely to auto-enroll participants. For example, while no 403(b) plans in the BrightScope database with less than \$1 million in plan assets auto-enrolled participants, 26.8 percent of plans with \$500 million to \$1 billion in plan assets and 20.0 percent of plans with more than \$1 billion had auto-enrollment. Similarly, 1.7 percent of plans with fewer than 100 participants included an auto-enrollment feature, which rose to 33.9 percent of plans with 5,000 to 9,999 participants, and fell slightly to 30.6 percent among plans with 10,000 participants or more (Exhibit 2.6).

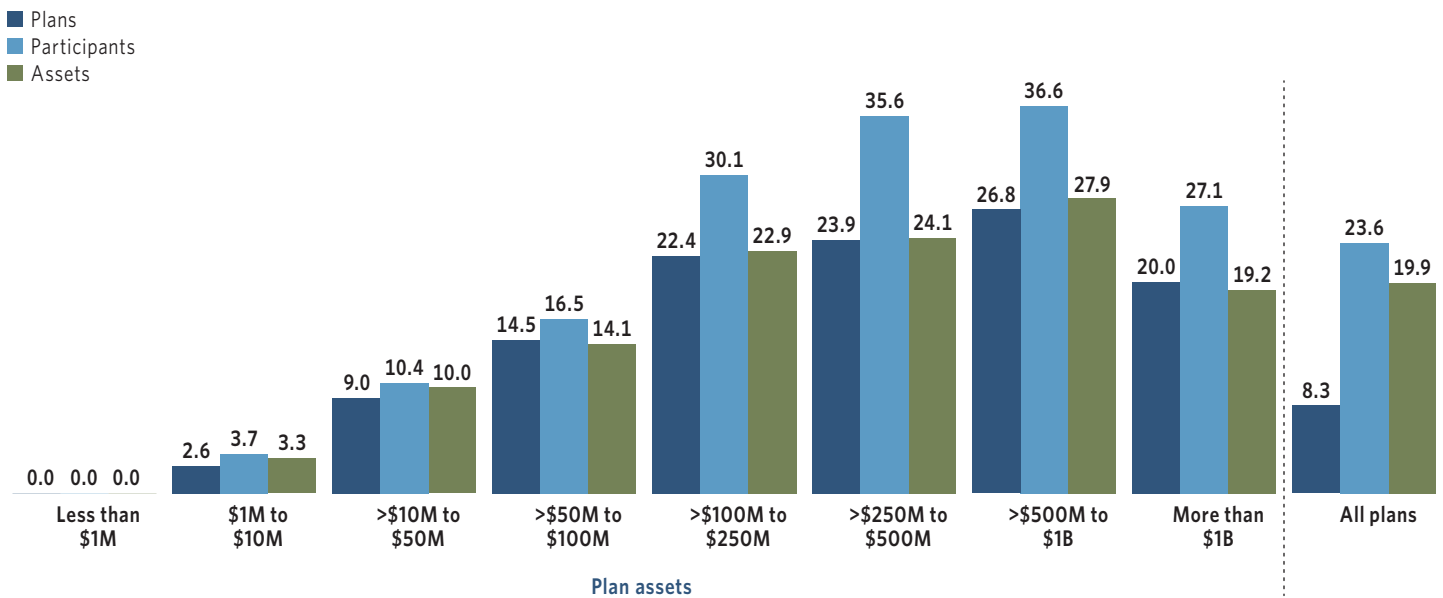
## Default Contribution Rates

Among ERISA 403(b) plans with auto-enrollment in 2012, the most popular default initial contribution rate was 3 percent of participant salary; 43 percent of plans with an auto-enrollment feature set default participant contributions at that rate (Exhibit 2.7). The next most common default rates were 2 percent and 4 percent, used in 19 percent and 14 percent of plans, respectively. Another 13 percent of plans with auto-enrollment implemented a default initial contribution rate of at least 5 percent. A plan's auto-enrollment design also may have an auto-increase or auto-escalation feature. Unfortunately, the audited Form 5500 filings do not have complete information on auto-increase design.

EXHIBIT 2.5

### Larger ERISA 403(b) Plans Tend to Be More Likely to Automatically Enroll Participants

Percentage of plans, participants, or assets with auto-enrollment feature among plans with audited 403(b) filings in the BrightScope database by plan assets (2012)



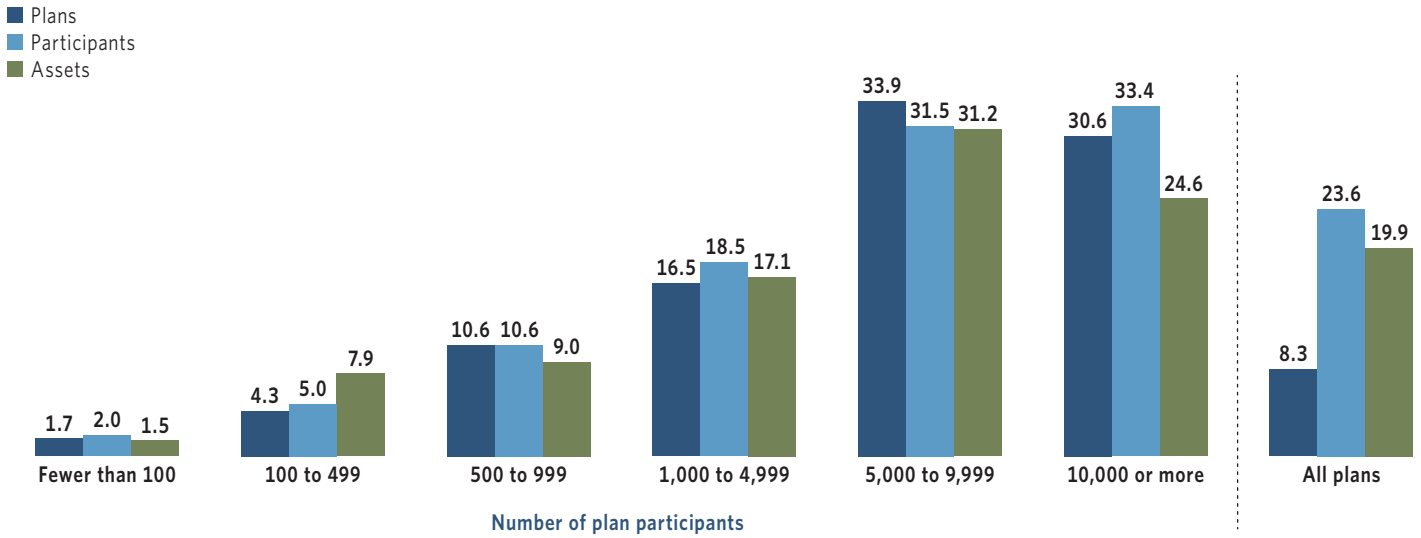
Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more. A plan was determined to have automatic enrollment if it was specified in the audited report; this may undercount the number of plans with automatic enrollment.

Source: BrightScope Defined Contribution Plan Database

EXHIBIT 2.6

**ERISA 403(b) Plans with More Participants Tend to Be More Likely to Automatically Enroll Participants**

Percentage of plans, participants, or assets with auto-enrollment feature among plans with audited 403(b) filings in the BrightScope database by number of plan participants (2012)



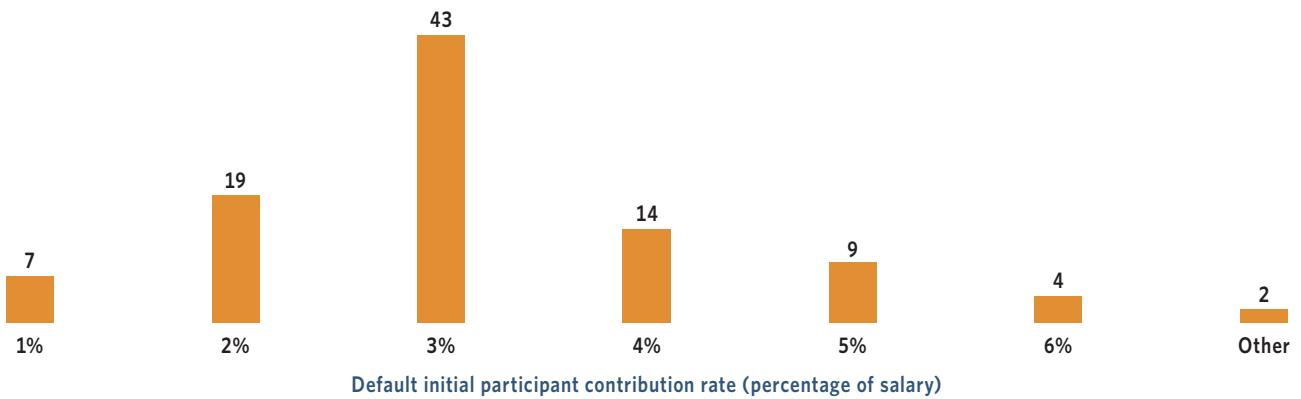
Note: The sample is 3,924 plans with \$270.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more. A plan was determined to have automatic enrollment if it was specified in the audited report; this may undercount the number of plans with automatic enrollment.

Source: BrightScope Defined Contribution Plan Database

EXHIBIT 2.7

**Default Initial Contribution Rate Among ERISA 403(b) Plans with Auto-Enrollment**

Percentage of plans with auto-enrollment among plans with audited 403(b) filings in the BrightScope database, 2012



Note: The sample is 202 plans with detailed auto-enrollment information. Audited 403(b) filings generally include plans with 100 participants or more. Components do not add to 100 percent because of rounding.

Source: BrightScope Defined Contribution Plan Database

## CHAPTER 3

# ERISA 403(b) Plan Fees

Employers offering 403(b) plans typically hire service providers to assist in operating the plans, and those service providers charge fees for their services. Many types of services are required to operate a 403(b) plan, including administrative services (e.g., recordkeeping and transaction processing), participant-focused services (e.g., participant communication, education, or advice), regulatory and compliance services (e.g., plan document services; consulting, accounting, and audit services; and legal advice), annuity processing, and investment management. As with any other employee benefit, the employer typically decides how the costs will be shared. In order to cover the expenses of providing a 403(b) plan, fees are paid by the plan itself, the employer, and/or the plan participants. These fees can be levied based on the number of participants, the amount of assets, or as a fixed dollar amount for the plan as a whole. In order to better understand the impact of fees, BrightScope has developed a total plan cost measure that includes all fees on the audited Form 5500 reports as well as fees paid through investment expense ratios (see the box below).

### Total Plan Cost

When looking at overall 403(b) plan fees, it is important to consider the sample to be analyzed. Fees can be calculated at the plan level (where each plan is treated equally), at the participant level (where each participant is treated equally), or at the asset level (where each dollar is treated equally). Because the average plan tends to be small, and the average participant and average dollar are in larger plans, the particular focus of the fee analysis can produce different answers. For this reason, total plan cost is presented on a plan-weighted, participant-weighted, and asset-weighted basis.

In 2012, the average ERISA 403(b) plan in the BrightScope sample had a total plan cost of 0.75 percent of assets, while the average participant was in a plan with a total plan cost of 0.58 percent of assets, and the average dollar was in a plan with a total plan cost of 0.51 percent of assets (Exhibit 3.1). This pattern occurs for a couple of reasons. First, participants and assets tend to be concentrated in larger plans. For example, although only 1 percent of audited ERISA 403(b) plans in the BrightScope Defined Contribution Plan Database have more than \$1 billion in plan assets, about one-sixth of participants are in these plans, and they hold about 30 percent of all 403(b) assets (see Exhibit 1.4). A similar pattern occurs in the DOL 403(b) universe.

#### ABOUT BRIGHTSCOPE'S TOTAL PLAN COST

*Total plan cost* includes asset-based investment management fees, asset-based administrative and advice fees, and other fees (including insurance charges) from the Form 5500 and audited financial statements of 403(b) plans covered by ERISA. When plans use products registered under the Investment Company Act of 1940—such as mutual funds—expense data from Lipper are used to calculate fees.

Another reason that participant-weighted and asset-weighted total plan costs are lower than plan-weighted total plan cost is because larger plans tend to have a lower total plan cost when measured as a percentage of plan assets. For example, ERISA 403(b) plans with less than \$1 million in plan assets had an average total plan cost of 1.39 percent of plan assets in 2012, compared with 0.54 percent of plan assets for plans with \$100 million to \$250 million and 0.45 percent of plan assets for plans with more than \$1 billion (Exhibit 3.1, upper panel). Similar patterns occur for both the participant-weighted and asset-weighted numbers. One reason that larger plans tend to have lower fees is related to the greater share of their assets invested in index funds (Exhibit 1.10), which tend to have lower expenses than other types of investments (Exhibit 3.3). In addition, there are fixed costs associated with offering a 403(b) plan. As a plan grows in size, those fixed costs can be spread over more participants and a larger asset base, lowering the total plan cost as a percentage of assets.

Since 2009, ERISA 403(b) total plan cost has decreased on average by between 5 and 10 basis points whether measured on a plan, participant, or asset-weighted basis (Exhibit 3.1). For example, total plan cost decreased from 0.80 percent in 2009 to 0.75 percent in 2012 on a plan-weighted basis, from 0.68 percent to 0.58 percent on a participant-weighted basis, and from 0.59 percent to 0.51 percent on an asset-weighted basis. Most plan size groups saw declines in total plan cost between 2009 and 2012.

ERISA 403(b) total plan costs varied around the plan-weighted average of 0.75 percent in 2012. For example, 10 percent of plans had a total plan cost of 0.46 percent or less, while another 10 percent had a total plan cost of 1.25 percent or more (Exhibit 3.2). Although there is significant diversity in total plan cost, the difference between the 10th percentile and 90th percentile plans tends to decrease as plan size increases. For example, in ERISA 403(b) plans with less than \$1 million in plan assets, total plan cost for 80 percent of plans ranged between 0.68 percent and 2.20 percent of assets. For plans with more than \$1 billion in plan assets, that range was significantly narrower, varying from 0.32 percent of assets to 0.54 percent.

#### FEES PAID ON MUTUAL FUNDS HELD IN 403(b) PLANS

BrightScope's database of ERISA 403(b) audited Form 5500 filings contains reporting of mutual fund holdings by share class in DC plans for about 50 percent of the plans in the database. In the remaining cases where the mutual fund is known, but not the specific share class, BrightScope assigns a share class to the mutual fund holdings in a given plan based on the size of the plan's investment in the mutual fund. If the plan has less than \$1 million invested in the mutual fund, a retail-type share class is assigned to the holding. If the plan has \$1 million or more invested in the mutual fund, then an institutional-type share class is assigned. BrightScope matches Lipper fee information by mutual fund share class to estimate the fees paid by plan participants on their mutual fund holdings in their DC plans. Morningstar fee data were used for the underlying total expense ratios of variable annuity mutual funds. Because BrightScope has plan-level information, it is possible to report how mutual fund fees vary across plan size and in aggregate.

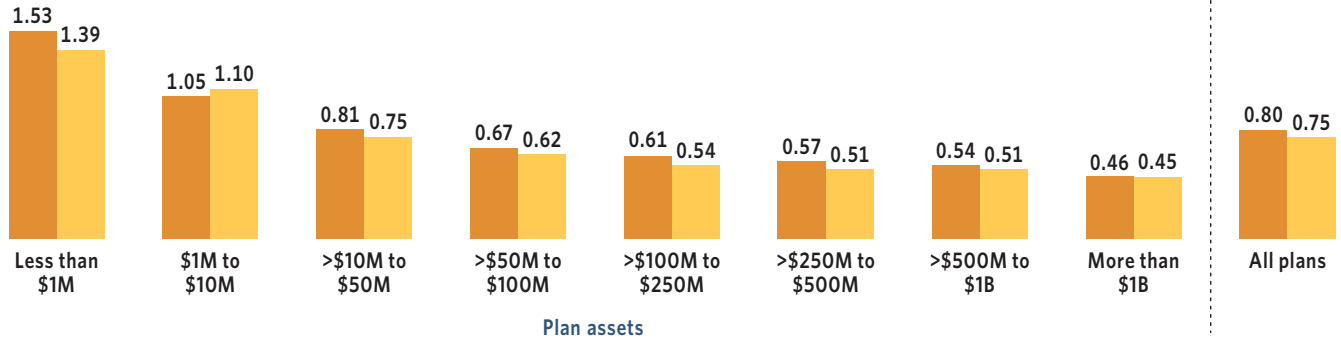
EXHIBIT 3.1

**ERISA 403(b) Total Plan Cost by Plan Assets**

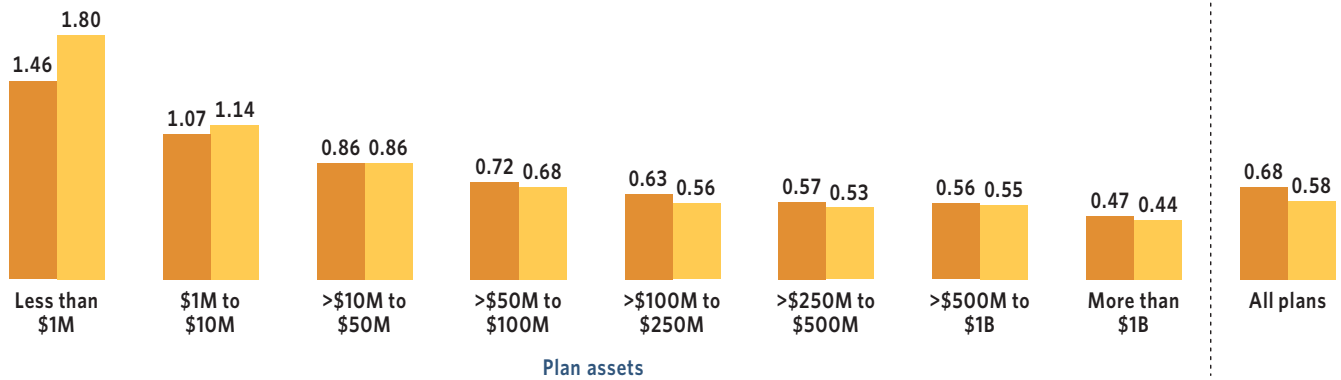
Total plan cost\* as a percentage of assets by plan assets among plans with audited 403(b) filings in the BrightScope database, 2009 and 2012

■ 2009  
■ 2012

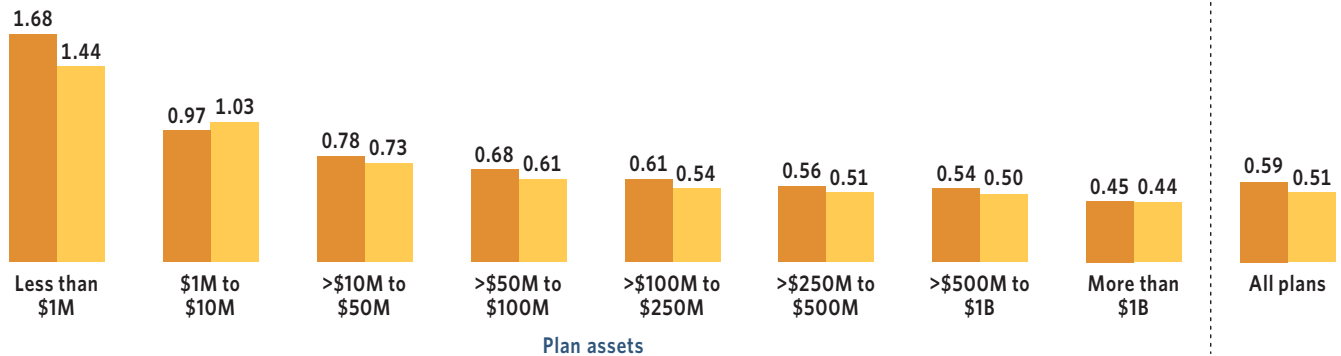
**Plan-weighted**



**Participant-weighted**



**Asset-weighted**



\* Total plan cost is BrightScope's measure of the total cost of operating the 403(b) plan and includes asset-based investment management fees, asset-based administrative and advice fees, and other fees (including insurance charges) from the Form 5500 and audited financial statements of ERISA-covered 403(b) plans. Total plan cost is computed only for plans with sufficiently complete information.

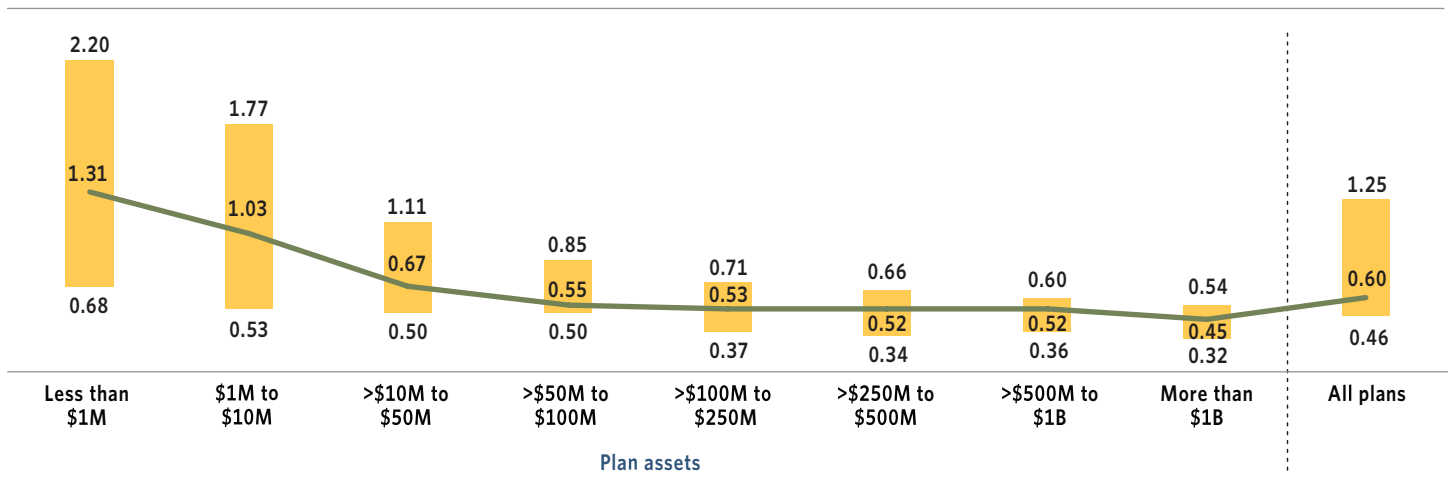
Note: The samples are 1,569 plans with \$139.4 billion in assets in 2009 and 1,478 plans with \$226.7 billion in assets in 2012. Audited 403(b) filings generally include plans with 100 participants or more.

Sources: BrightScope Defined Contribution Plan Database and Lipper

EXHIBIT 3.2

**Distribution of ERISA 403(b) Total Plan Cost by Plan Assets**

10th percentile, median, and 90th percentile plan-weighted total plan cost\* as a percentage of assets among plans with audited 403(b) filings in the BrightScope database by plan assets (2012)



\* Total plan cost is BrightScope’s measure of the total cost of operating the 403(b) plan and includes asset-based investment management fees, asset-based administrative and advice fees, and other fees (including insurance charges) from the Form 5500 and audited financial statements of ERISA-covered 403(b) plans. Total plan cost is computed only for plans with sufficiently complete information.

Note: The sample is 1,478 plans with \$226.7 billion in assets. Audited 403(b) filings generally include plans with 100 participants or more.

Sources: BrightScope Defined Contribution Plan Database and Lipper

**Mutual Fund Expenses in ERISA 403(b) Plans**

Some of the main costs of a 403(b) plan are the expenses associated with the investments in the plan. Therefore, it is important to understand factors associated with these expenses (such as plan size or investment objective).

**Mutual Fund Expenses by 403(b) Plan Size**

In 2012, the asset-weighted average expense ratios of mutual funds in ERISA 403(b) plans in the BrightScope Defined Contribution Plan Database varied both with the size of the plan (with larger plans, measured by assets, tending to have concentrated assets in mutual funds with lower expense ratios) and the type of investment (with domestic mutual funds tending to have lower expense ratios than international mutual funds, and money market mutual funds tending to have lower expense ratios than equity or bond mutual funds) (Exhibit 3.3).

The asset-weighted average expense ratio for domestic equity mutual funds held in ERISA 403(b) plans in 2012 was 0.53 percent of assets, ranging from 0.81 percent in 403(b) plans with less than \$1 million in plan assets to 0.48 percent in plans with more than \$1 billion (Exhibit 3.3, upper panel).<sup>20</sup>

Expense ratios for international equity mutual funds held in ERISA 403(b) plans were higher compared with domestic equity mutual funds, with an asset-weighted average of 0.65 percent of assets, ranging from 1.03 percent of assets in 403(b) plans with less than \$1 million in plan assets to 0.55 percent in plans with more than \$1 billion. Expense ratios for mutual funds tended not to vary significantly for plans with different numbers of participants (Exhibit 3.3, lower panel).

In ERISA 403(b) plans, the average expense ratios for domestic bond mutual funds were lower than domestic equity mutual fund expense ratios (0.45 percent of assets for domestic bond mutual funds, compared with 0.53 percent of assets for domestic equity mutual funds), but expense ratios for international bond mutual funds were significantly higher than for international equity mutual funds (0.82 percent of assets for international bond and 0.65 percent of assets for international equity mutual funds) (Exhibit 3.3). Money market mutual funds had the lowest expense ratio of any of the asset classes, with an asset-weighted average expense ratio of 0.19 percent of assets in 2012 for money market mutual funds in ERISA 403(b) plans.

## EXHIBIT 3.3

**Average Expense Ratios of Mutual Funds in ERISA 403(b) Plans, 2012**

Asset-weighted average expense ratio as a percentage of mutual fund assets among plans with audited 403(b) filings in the BrightScope database by mutual fund investment objective, percent (2012)

Plan assets	Equity mutual funds		Balanced mutual funds		Bond mutual funds		Money market mutual funds	Other	Memo: index mutual funds
	Domestic	International	Target date mutual funds*	Non-target date balanced mutual funds	Domestic	International			
Less than \$1M	0.81	1.03	0.93	0.94	0.74	0.94	0.20	1.08	0.47
\$1M to \$10M	0.67	0.85	0.81	0.82	0.64	0.81	0.18	0.91	0.35
>\$10M to \$50M	0.57	0.71	0.74	0.66	0.53	0.90	0.19	0.90	0.33
>\$50M to \$100M	0.58	0.70	0.69	0.61	0.51	0.85	0.19	1.00	0.30
>\$100M to \$250M	0.55	0.68	0.58	0.61	0.48	0.76	0.19	0.78	0.24
>\$250M to \$500M	0.54	0.63	0.55	0.48	0.44	0.73	0.22	0.73	0.21
>\$500M to \$1B	0.52	0.68	0.52	0.48	0.43	0.83	0.21	0.69	0.20
More than \$1B	0.48	0.55	0.35	0.32	0.37	0.84	0.17	0.63	0.18
All plans	0.53	0.65	0.52	0.49	0.45	0.82	0.19	0.77	0.22

Number of plan participants	Equity mutual funds		Balanced mutual funds		Bond mutual funds		Money market mutual funds	Other	Memo: index mutual funds
	Domestic	International	Target date mutual funds*	Non-target date balanced mutual funds	Domestic	International			
Fewer than 100	0.50	0.56	0.54	0.66	0.47	0.66	0.17	0.81	0.31
100 to 499	0.54	0.66	0.73	0.69	0.51	0.86	0.18	0.87	0.37
500 to 999	0.53	0.64	0.68	0.68	0.48	0.87	0.19	0.88	0.34
1,000 to 4,999	0.55	0.68	0.59	0.54	0.48	0.84	0.19	0.82	0.25
5,000 to 9,999	0.53	0.64	0.54	0.48	0.43	0.76	0.20	0.67	0.20
10,000 or more	0.51	0.63	0.42	0.38	0.39	0.84	0.20	0.68	0.16
All plans	0.53	0.65	0.52	0.49	0.45	0.82	0.19	0.77	0.22

\* A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

Note: The sample is 3,687 plans with \$183.2 billion in mutual fund assets. Audited 403(b) filings generally include plans with 100 participants or more. See the callout box on page 36 for a description of the fee analysis. The underlying total expense ratios of variable annuity mutual funds are included.

Sources: BrightScope Defined Contribution Plan Database, Lipper, and Morningstar

Index mutual funds, which tend to be domestic equity index mutual funds,<sup>21</sup> tended to have lower expense ratios than other fund types. For example, the asset-weighted average expense ratio for index mutual funds in ERISA 403(b) plans was 0.22 percent of assets in 2012, compared with 0.53 percent of assets for domestic equity mutual funds (including both index and actively managed funds) (Exhibit 3.3). Like other mutual fund types, index mutual funds also tend to have lower expense ratios in larger plans. For example, index mutual funds in plans with less than \$1 million in plan assets had an average expense ratio of 0.47 percent of assets, compared with 0.18 percent in plans with more than \$1 billion in plan assets. Similarly, index mutual funds in plans with fewer than 100 participants had an asset-weighted average expense ratio of 0.31 percent of assets, compared with 0.16 percent in plans with 10,000 participants or more.

Mutual fund expenses decreased between 2009 and 2012 in ERISA 403(b) plans across all asset classes, according to cross-sectional data. For example, domestic equity mutual funds had an asset-weighted average expense ratio of 0.53 percent in 2012, down from 0.56 percent in 2009 (Exhibits 3.3 and 3.4). Money market mutual funds experienced the largest decline in expenses, falling from 0.38 percent of assets in 2009 to 0.19 percent in 2012. This decline in money market mutual fund expenses was larger for smaller 403(b) plans, which tended to have higher expenses to begin with. For example, in 403(b) plans with less than \$1 million in plan assets, expenses on money market mutual funds decreased by more than half between 2009 and 2012, falling from 0.52 percent to 0.20 percent of assets. However, plans in all size categories experienced decreases in their money market mutual fund expenses on average. For example, in 403(b) plans with more than \$1 billion in plan assets, money market mutual fund expenses declined by 18 basis points between 2009 and 2012, falling from 0.35 percent of assets to 0.17 percent. Some of the decline in money market mutual fund asset-weighted average expenses may be attributable to fee waivers, which increased substantially in money market funds due to the low interest rate environment following the market turmoil of 2008.<sup>22</sup>

### *Variation in Mutual Fund Expenses*

In addition to the average expense ratio, it is important to examine different points in the distribution of expenses to understand the range of mutual fund expenses paid in 403(b) plans. For example, while the asset-weighted average expense ratio on domestic equity mutual funds held in ERISA 403(b) plans was 0.53 percent in 2012 (Exhibit 3.3), 10 percent of assets were invested in funds with expense ratios of 0.17 percent or less, while 10 percent of assets were invested in funds with expense ratios of 0.89 percent or more (see Exhibits 3.5 and A.3). Similar patterns were observed for international equity mutual funds.

Although 403(b) equity mutual fund expenses tend to decrease as total assets in a 403(b) plan increase, mutual fund expenses vary in plans of all sizes. For example, expenses for equity mutual funds ranged from 0.47 percent at the asset-weighted 10th percentile to 1.37 percent at the asset-weighted 90th percentile in 403(b) plans with less than \$1 million in plan assets (see Exhibits 3.5 and A.3). Similarly, equity mutual fund expenses in ERISA 403(b) plans with more than \$1 billion in plan assets ranged between 0.08 percent of assets at the asset-weighted 10th percentile to 0.81 percent at the asset-weighted 90th percentile.

The range in expenses is at least partly attributable to differences in fee arrangements. For example, while some or all costs associated with plan recordkeeping can be paid by fees associated with the mutual fund investment, other costs may be paid as a per-participant charge by participants or the employer. Expenses also may be paid through a combination of these methods. In addition, the expense ratios applicable to funds vary within a given investment category.<sup>23</sup> For example, actively managed mutual funds can offer investors the chance to earn superior returns, access specialized sectors, or take advantage of alternative investment strategies, all of which can make a fund more expensive to manage. Similarly, equity mutual funds may be priced differently depending on the extent to which they invest in small-cap, mid-cap, or emerging market stocks (which tend to be more expensive to manage) instead of large-cap or developed market stocks (which tend to be less expensive to manage).



EXHIBIT 3.4

**Average Expense Ratios of Mutual Funds in ERISA 403(b) Plans, 2009**

Asset-weighted average expense ratio as a percentage of mutual fund assets among plans with audited 403(b) filings in the BrightScope database by mutual fund investment objective, percent

Plan assets	Equity mutual funds		Balanced mutual funds		Bond mutual funds		Money market mutual funds	Other	Memo: index mutual funds
	Domestic	International	Target date mutual funds*	Non-target date balanced mutual funds	Domestic	International			
Less than \$1M	0.80	0.97	0.97	0.95	0.67	0.97	0.52	0.95	0.38
\$1M to \$10M	0.67	0.85	0.86	0.82	0.62	0.88	0.43	0.85	0.35
>\$10M to \$50M	0.60	0.75	0.81	0.79	0.55	0.89	0.41	0.88	0.35
>\$50M to \$100M	0.57	0.71	0.62	0.75	0.50	0.80	0.39	0.88	0.30
>\$100M to \$250M	0.59	0.74	0.69	0.65	0.49	0.80	0.38	0.84	0.27
>\$250M to \$500M	0.56	0.69	0.62	0.61	0.45	0.91	0.39	0.79	0.24
>\$500M to \$1B	0.52	0.67	0.72	0.50	0.42	0.91	0.36	0.79	0.24
More than \$1B	0.50	0.62	0.45	0.39	0.37	0.91	0.35	0.68	0.20
All plans	0.56	0.70	0.65	0.61	0.47	0.88	0.38	0.82	0.26

Number of plan participants	Equity mutual funds		Balanced mutual funds		Bond mutual funds		Money market mutual funds	Other	Memo: index mutual funds
	Domestic	International	Target date mutual funds*	Non-target date balanced mutual funds	Domestic	International			
Fewer than 100	0.62	0.79	0.78	0.80	0.56	0.93	0.42	0.82	0.32
100 to 499	0.54	0.69	0.80	0.78	0.51	0.86	0.41	0.80	0.36
500 to 999	0.56	0.70	0.80	0.78	0.51	0.97	0.41	0.89	0.37
1,000 to 4,999	0.57	0.72	0.70	0.68	0.50	0.87	0.38	0.83	0.30
5,000 to 9,999	0.58	0.74	0.70	0.59	0.44	0.83	0.38	0.88	0.25
10,000 or more	0.53	0.66	0.54	0.46	0.40	0.91	0.35	0.74	0.18
All plans	0.56	0.70	0.65	0.61	0.47	0.88	0.38	0.82	0.26

\* A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

Note: The sample is 2,999 plans with \$59.5 billion in mutual fund assets. Audited 403(b) filings generally include plans with 100 participants or more. See the callout box on page 36 for a description of the fee analysis. The underlying total expense ratios of variable annuity mutual funds are included.

Sources: BrightScope Defined Contribution Plan Database, Lipper, and Morningstar

EXHIBIT 3.5

**Distribution of Mutual Fund Expense Ratios Paid by ERISA 403(b) Plan Participants**

10th percentile, median, and 90th percentile asset-weighted mutual fund expense ratios as a percentage of plan assets among plans with audited 403(b) filings in the BrightScope database by investment objective and plan assets, percent (2012)



Note: The sample is 3,687 plans with \$183.2 billion in mutual fund assets. Audited 403(b) filings generally include plans with 100 participants or more. For detailed expense information, see Exhibit A.3 in the appendix. See the callout box on page 36 for a description of the fee analysis.

Sources: BrightScope Defined Contribution Plan Database, Lipper, and Morningstar

# Appendix

## EXHIBIT A.1

### Conditional Average Number of Investment Options by Type of Investment in ERISA 403(b) Plans

Average number of investment options among plans with audited 403(b) filings in the BrightScope database offering a given investment option by plan assets (2012)

Plan assets	Equity funds		Balanced funds		Bond funds			Money funds	Fixed annuities	Other <sup>2</sup>	Memo: index funds
	Domestic	International	Target date funds <sup>1</sup>	Non-target date balanced funds	Domestic	International					
Less than \$1M	6.0	2.2	6.4	1.8	1.7	1.1	1.2	1.2	1.3	2.8	
\$1M to \$10M	7.6	2.2	7.2	1.8	2.2	1.1	1.3	1.3	1.1	3.1	
>\$10M to \$50M	7.5	2.1	9.7	1.1	2.5	1.1	1.3	1.3	1.1	3.2	
>\$50M to \$100M	8.4	2.3	11.2	0.9	2.5	1.0	1.3	1.4	1.1	3.4	
>\$100M to \$250M	8.9	2.4	13.5	1.0	2.7	1.1	1.4	1.5	1.2	4.4	
>\$250M to \$500M	9.6	2.5	16.2	1.0	3.1	1.0	1.7	1.5	1.3	5.6	
>\$500M to \$1B	10.7	2.7	18.9	1.4	3.5	1.1	1.7	1.3	1.4	6.0	
More than \$1B	10.2	2.5	20.8	1.2	3.5	1.0	1.9	1.5	1.4	8.4	
All plans	7.8	2.2	9.8	1.4	2.4	1.1	1.3	1.3	1.1	3.5	

<sup>1</sup> A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

<sup>2</sup> Other includes commodity funds, real estate funds, and brokerage accounts, but each separate option is counted as a unique investment option.

Note: The sample is 3,924 plans with \$270.7 billion in assets. Participant loans are excluded. Funds include mutual funds and variable annuities. Audited 403(b) filings generally include plans with 100 participants or more. Investment options include mutual fund, variable annuity, and fixed annuity options. Core investment options are those that have at least 0.5 percent of plan assets. The funds in a target date fund suite are included if at least 0.5 percent of plan assets are invested in that suite.

Source: BrightScope Defined Contribution Plan Database

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EXHIBIT A.2

**Employer Contribution Activity in ERISA 403(b) Plans**

*Percentage of 403(b) plans with 100 participants or more with employer contributions (by plan assets, plan year 2009-2012)*

<b>Plan assets</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Less than \$1M	56	62	64	63
\$1M to \$10M	73	75	76	77
>\$10M to \$50M	78	79	80	81
>\$50M to \$100M	78	79	81	83
>\$100M to \$250M	74	75	80	78
>\$250M to \$500M	72	77	80	80
>\$500M to \$1B	75	69	73	70
More than \$1B	91	86	84	83
All	73	75	76	78

Note: The sample includes 403(b) plans with 100 participants or more.

Source: ICI tabulations of U.S. Department of Labor Form 5500 Research File

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EXHIBIT A.3

**Detailed Distribution of Mutual Fund Expense Ratios in ERISA 403(b) Plans**

10th percentile, median, and 90th percentile asset-weighted mutual fund expense ratios as a percentage of plan assets among plans with audited 403(b) filings in the BrightScope database by investment objective and plan assets, percent (2012)

**10th percentile**

	Equity mutual funds			Balanced mutual funds			Bond mutual funds			Money market mutual funds	Other	Memo: index mutual funds
	All	Domestic	International	All	Target date mutual funds*	Non-target date balanced mutual funds	All	Domestic	International			
Less than \$1M	0.47	0.40	0.53	0.60	0.70	0.30	0.43	0.43	0.88	0.08	0.84	0.10
\$1M to \$10M	0.40	0.37	0.53	0.18	0.17	0.25	0.40	0.40	0.52	0.08	0.84	0.15
>\$10M to \$50M	0.40	0.40	0.50	0.18	0.18	0.17	0.41	0.40	0.60	0.16	0.84	0.10
>\$50M to \$100M	0.34	0.34	0.50	0.18	0.18	0.17	0.40	0.39	0.79	0.09	0.75	0.05
>\$100M to \$250M	0.28	0.21	0.46	0.17	0.17	0.17	0.20	0.20	0.64	0.09	0.23	0.05
>\$250M to \$500M	0.17	0.17	0.33	0.17	0.17	0.17	0.12	0.12	0.55	0.09	0.24	0.04
>\$500M to \$1B	0.17	0.16	0.18	0.17	0.17	0.17	0.12	0.12	0.64	0.09	0.24	0.05
More than \$1B	0.08	0.08	0.12	0.16	0.16	0.16	0.07	0.07	0.84	0.09	0.24	0.05
All plans	0.19	0.17	0.30	0.17	0.16	0.17	0.12	0.12	0.64	0.09	0.24	0.05

**Median**

	Equity mutual funds			Balanced mutual funds			Bond mutual funds			Money market mutual funds	Other	Memo: index mutual funds
	All	Domestic	International	All	Target date mutual funds*	Non-target date balanced mutual funds	All	Domestic	International			
Less than \$1M	0.81	0.73	0.85	0.86	0.79	0.95	0.85	0.85	0.89	0.17	1.18	0.43
\$1M to \$10M	0.53	0.49	0.82	0.77	0.77	0.77	0.59	0.58	0.89	0.17	0.84	0.33
>\$10M to \$50M	0.49	0.49	0.53	0.73	0.73	0.63	0.45	0.45	0.89	0.17	0.84	0.40
>\$50M to \$100M	0.49	0.49	0.53	0.71	0.71	0.64	0.45	0.45	0.89	0.17	1.01	0.30
>\$100M to \$250M	0.49	0.49	0.55	0.64	0.64	0.60	0.45	0.45	0.72	0.17	0.79	0.18
>\$250M to \$500M	0.49	0.49	0.53	0.60	0.62	0.52	0.45	0.45	0.84	0.17	0.77	0.17
>\$500M to \$1B	0.49	0.49	0.53	0.58	0.58	0.47	0.45	0.45	0.84	0.17	0.79	0.17
More than \$1B	0.49	0.49	0.53	0.18	0.18	0.25	0.45	0.45	0.84	0.17	0.68	0.17
All plans	0.49	0.49	0.53	0.59	0.59	0.47	0.45	0.45	0.84	0.17	0.84	0.17

Continued on next page

EXHIBIT A.3 CONTINUED

**Detailed Distribution of Mutual Fund Expense Ratios in ERISA 403(b) Plans**

10th percentile, median, and 90th percentile asset-weighted mutual fund expense ratios as a percentage of plan assets among plans with audited 403(b) filings in the BrightScope database by investment objective and plan assets, percent (2012)

90th percentile

	Equity mutual funds			Balanced mutual funds			Bond mutual funds			Money market mutual funds	Other	Memo: index mutual funds
	All	Domestic	International	All	Target date mutual funds*	Non-target date balanced mutual funds	All	Domestic	International			
Less than \$1M	1.37	1.26	1.62	1.41	1.46	1.41	0.99	0.96	1.21	0.31	1.51	0.93
\$1M to \$10M	1.24	1.20	1.35	1.32	1.32	1.39	0.96	0.95	1.11	0.28	1.30	0.65
>\$10M to \$50M	1.02	0.98	1.15	1.13	1.13	1.23	0.85	0.85	1.02	0.31	1.26	0.49
>\$50M to \$100M	1.00	0.98	1.14	0.96	0.97	0.88	0.85	0.85	0.90	0.36	1.30	0.45
>\$100M to \$250M	0.96	0.91	1.08	0.78	0.76	0.98	0.72	0.72	0.89	0.38	1.26	0.45
>\$250M to \$500M	0.91	0.90	1.00	0.76	0.75	0.78	0.72	0.72	0.84	0.38	1.01	0.45
>\$500M to \$1B	0.90	0.84	1.10	0.74	0.73	0.78	0.72	0.72	0.89	0.38	1.00	0.44
More than \$1B	0.81	0.77	0.99	0.69	0.66	0.75	0.70	0.58	0.89	0.31	1.13	0.43
All plans	0.91	0.89	1.07	0.78	0.76	0.82	0.72	0.72	0.89	0.38	1.19	0.45

Note: The sample is 3,687 plans with \$183.2 billion in mutual fund assets. Audited 403(b) filings generally include plans with 100 participants or more. See the callout box on page 36 for a description of the fee analysis.

Sources: BrightScope Defined Contribution Plan Database, Lipper, and Morningstar

# Notes

- <sup>1</sup> See Internal Revenue Service 2015, Giller 2009, and Hallsten and Architect 1994.
- <sup>2</sup> See Internal Revenue Service 2015.
- <sup>3</sup> See Giller 2009 and Richardson and Gallagher 2010.
- <sup>4</sup> See Giller 2009 and Richardson and Gallagher 2010.
- <sup>5</sup> See Richardson and Gallagher 2010. Keim and Mitchell 2015, studying the defined contribution plan at a large nonprofit institution, explores the benefits of streamlining defined contribution plan investment lineups.
- <sup>6</sup> As of 2009, 403(b) plans falling under ERISA were required to file participation and financial information. This new reporting requirement led to a jump in the number of 403(b) plan participants and assets reported. ERISA 403(b) plan assets jumped from \$1.5 billion in 2008 to \$203.2 billion in 2009 (see U.S. Department of Labor, Employee Benefits Security Administration 2012c and 2015b).
- <sup>7</sup> For example, see Clark and Richardson 2010; Yakoboski and Conley 2013; and Clark and Hanson 2013.
- <sup>8</sup> See Clark and Richardson 2010.
- <sup>9</sup> This exhibit reports total 403(b) plan assets estimated by ICI (see Investment Company Institute 2015b) and total ERISA 403(b) plan assets estimated from the BrightScope Defined Contribution Plan Database in 2012 (see Exhibit I.4). The total ERISA 403(b) plan estimates from the BrightScope Defined Contribution Plan Database are slightly higher than the totals published by the Department of Labor (see U.S. Department of Labor, Employee Benefits Security Administration 2015a) because of late filers and other data amendments that may have occurred since the publication of the Department of Labor results.
- <sup>10</sup> For more information on filing requirements, see U.S. Department of Labor, Employee Benefits Security Administration 2012d.
- <sup>11</sup> See U.S. Department of Labor, Employee Benefits Security Administration 2014c.
- <sup>12</sup> For example, see Richardson and Bisette 2014 and Goodman and Richardson 2014.
- <sup>13</sup> For example, see Clark and Richardson 2010.
- <sup>14</sup> Defined contribution retirement plans are one of many employee benefits an employer may choose to offer. See Collins et al. 2014 for a discussion of the services and expenses of offering 401(k) plans.
- <sup>15</sup> See Richardson and Gallagher 2010; Clark and Richardson 2010; and Yakoboski and Conley 2013.
- <sup>16</sup> In 2012, employee deferrals were capped at \$17,000, while the combination of employee and employer deferrals was capped at \$50,000. Employees aged 50 or older in 2012 could make an additional catch-up contribution of \$5,500.
- <sup>17</sup> The sample is limited to 403(b) plans with 100 participants or more in order to match the BrightScope audited sample of plans. In 2009, 62 percent of all ERISA 403(b) plans had employer contributions, rising to 66 percent in 2010, and 67 percent in 2011 and 2012.
- <sup>18</sup> Plans with employer matches but missing descriptions of the employer match may be included in this category.
- <sup>19</sup> A plan was determined to have automatic enrollment if it was specified in the audited report; this may undercount the number of plans with automatic enrollment. Plan Sponsor Council of America 2014 reports that 16.0 percent of 403(b) plans in their survey automatically enrolled participants in 2013.

<sup>20</sup> Funds for which fee data were not available have been excluded. In addition, the audited Form 5500 reports contain share class data for approximately half of funds in the BrightScope database. For the remainder, if a plan's investment in a fund was less than \$1 million in assets, it was assumed that the plan was invested in retail-type shares (A shares or their equivalents), while a plan's investment of \$1 million or more in a fund was assumed to be invested in institutional-type shares (institutional shares or their equivalents). The impact of this assumption was tested by assigning to each fund the simple average expense ratio of all of its share classes. This tends to increase the average expense ratios presented, but does not significantly alter the remaining analysis (whether comparing across asset categories or across number of plan participants).

<sup>21</sup> At year-end 2014, 70 percent of index mutual fund assets were invested in domestic equity indexes, 12 percent were in world equity indexes, and the remaining 18 percent were in bond and hybrid indexes. See Investment Company Institute 2015a.

<sup>22</sup> In 2012, money market funds waived \$4.8 billion in expenses, up from \$3.6 billion in 2009 and \$1.8 billion in 2008. For more information, see Gallagher 2014. For mutual fund fees and expenses through 2014, see Investment Company Institute 2015a.

<sup>23</sup> For a discussion of the range of services offered in S&P 500 index funds, see Collins 2005.



# Glossary

**automatic enrollment**

The practice of enrolling eligible employees in a plan and initiating participant deferrals unless the employee opts out.

**automatic increase**

A provision found in some defined contribution plans in which an employee's contribution rate is automatically increased at a preestablished point in time, unless the employee chooses otherwise.

**defined contribution (DC) plan**

An employer-sponsored retirement plan, such as a 401(k) plan or a 403(b) plan, in which contributions are made to individual participant accounts. Depending on the type of DC plan, contributions may be made by the employee, the employer, or both. The employee's benefits at retirement or termination of employment are based on the employee and employer contributions and earnings and losses on those contributions. See also **401(k) plan** and **403(b) plan**.

**eligible plan participant**

Any employee who is eligible to participate in and receive benefits from a plan.

**employer contribution**

A contribution made by the company to the account of the participant (often in the form of a company match based on a ratio to contributions made by the participant).

**ERISA**

The Employee Retirement Income Security Act of 1974 is a federal law governing employee benefit plans.

**expense ratio**

A measure of what it costs to operate a fund—disclosed in the prospectus and shareholder reports—expressed as a percentage of its assets.

**fixed annuity**

An investment contract sold by an insurance company. Capital is accumulated at a specified rate of interest with the option to convert to an income stream in retirement.

**Form 5500**

An annual disclosure submitted to the U.S. Department of Labor by ERISA-covered employer-sponsored retirement plans, including 401(k) and certain 403(b) plans.

**Form 5500 audited filing**

An independently audited report generally required by federal law for ERISA-covered employer-sponsored retirement plans with 100 participants or more.

**401(k) plan**

An employer-sponsored retirement plan that enables employees to make tax-deferred contributions from their salaries to the plan. See also **defined contribution (DC) plan**.

**403(b) plan**

An employer-sponsored retirement plan that enables employees of universities, public schools, and nonprofit organizations to make tax-deferred contributions from their salaries to the plan. See also **defined contribution (DC) plan**.

**fund**

A pooled investment product. In this report, funds include mutual funds and variable annuities.

**index fund**

A fund designed to track the performance of a market index. The fund's portfolio of securities is either a replicate or a representative sample of the designated market index. Often referred to as *passively managed portfolios*.

**mutual fund**

An investment company registered with the SEC that buys a portfolio of securities selected by a professional investment adviser to meet a specified financial goal (investment objective). Mutual funds can have actively managed portfolios, in which a professional investment adviser creates a unique mix of investments to meet a particular investment objective, or passively managed portfolios, in which the adviser seeks to track the performance of a selected benchmark or index. One hallmark of mutual funds is that they issue redeemable securities, meaning that the fund stands ready to buy back its shares at their current net asset value (NAV).

**plan assets**

The total assets held among all participants within the plan.

**recordkeeper**

A recordkeeper maintains plan records; processes employee enrollment; processes participants' investment elections, contributions, and distributions; and issues account statements to participants.

**target date fund**

A balanced fund that follows a predetermined reallocation of risk over a working career and into retirement for a person expecting to retire at the target date of the fund (which is usually included in the fund's name). These funds invest in a mix of asset classes and typically rebalance their portfolios over time to become less focused on growth and more focused on income as the fund approaches and passes the target date. Also known as a *lifecycle fund*.

**total plan cost**

BrightScope's measure of the total cost of operating the DC plan, which includes asset-based investment management fees, asset-based administrative and advice fees, and other fees (including insurance charges) from the Form 5500 and audited financial statements of ERISA-covered DC plans.

**variable annuity**

An investment contract sold by an insurance company. Capital is accumulated, often through mutual fund investments, with the option to convert to an income stream in retirement.

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