GAO Highlights

Highlights of GAO-15-578, a report to the Honorable Elizabeth Warren, U. S. Senate

Why GAO Did This Study

DOL created a regulatory “safe harbor” in 2007 to limit plan sponsor liability for investing contributions on behalf of employees into default investments when employees do not otherwise make an election. In addition, DOL identified three default investments that, if selected by sponsors, would qualify a plan for safe harbor protection. GAO was asked to review certain aspects of these default investment types.

This report examines: (1) which options plan sponsors selected as default investments and why; (2) how plan sponsors monitor their default investment selections; and (3) what challenges, if any, plan sponsors report facing when adopting a default investment for their plan. To answer these questions, GAO reviewed relevant federal laws and guidance; analyzed industry survey data on the prevalence of default investment use; analyzed nongeneralizable responses from 227 plan sponsors who voluntarily completed a GAO web-based questionnaire; and interviewed 96 stakeholders, including service providers, advocacy groups, and research organization representatives, as well as academicians.

What GAO Recommends

GAO recommends that DOL assess the challenges that plan sponsors and stakeholders reported, including the extent to which these challenges can be addressed, and implement corrective actions, as appropriate. DOL generally agreed with GAO’s recommendation.

View GAO-15-578. For more information, contact Charles Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

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401(K) PLANS

Clearer Regulations Could Help Plan Sponsors Choose Investments for Participants

What GAO Found

Employers who sponsor 401(k) plans report using a range of default investment types to automatically enroll employees in their plans based on each type’s design and other attributes. From 2009 through 2013, the majority of employers who sponsored 401(k) plans reported using a target-date fund as their default, according to data from three annual industry surveys that GAO reviewed. A target-date fund is a product or portfolio that changes asset allocations and associated risk levels over time with the objective of decreasing risk of losses with increasing age. Fewer plan sponsors reported using the other two default investment types that the Department of Labor (DOL) identified: balanced funds—products with a fixed ratio of equity to fixed-income investments—or managed account services—investment services that use participant information to customize asset allocations. Plan sponsors completing GAO’s questionnaire said that they generally looked for asset diversification, ease of participant understanding, limited fiduciary liability, and a fit with participant characteristics when selecting a default investment. Some stakeholders that GAO interviewed also identified positive attributes of each default investment type and highlighted other factors that could influence a plan sponsor’s default investment selection, such as plan sponsor preferences; plan circumstances; or changes in the plan’s environment like a plan merger or court decision.

Plan sponsors generally monitor plan investments, including default investments, periodically to ensure alignment with the plan's objectives and investment strategies, according to stakeholders GAO interviewed and plan sponsors responding to GAO’s questionnaire. Stakeholders that GAO interviewed generally said that the type of default investment and a plan’s circumstances—such as the availability of resources and expertise devoted to investment monitoring—can affect the extent of a plan sponsor’s monitoring efforts and the response to monitoring results. Plan sponsors responding to GAO’s questionnaire and stakeholders GAO interviewed said that after an extensive default selection process, some plan sponsors may be reluctant to change the default investment regardless of monitoring results. For example, a plan sponsor and service provider may have negotiated a reduction in overall plan investment management fees in exchange for using a provider’s investment as a plan’s default, making it more difficult to change.

Plan sponsors cited regulatory uncertainty, liability protection, and the adoption of innovative products as significant challenges when adopting one of the three default investments. DOL regulations outline several specific conditions that plan sponsors must adhere to in order to receive relief from liability for any investment losses to participants that occur as a result of the investment. Plan sponsors responding to GAO’s questionnaire and stakeholders GAO interviewed generally said that the regulations were unclear as to: (1) how sponsors could fulfill the regulatory requirement to factor the ages of participants into their default investment selection; (2) whether each default investment provided the same level of protection; or (3) whether they were allowed to incorporate other retirement features, such as products offering guaranteed retirement income, into a plan’s default investment. Such uncertainty could lead some plan sponsors to make suboptimal choices when selecting a plan’s default investment that could have long-lasting negative effects on participants’ retirement savings.