

## ICI VIEWPOINTS

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# Ten Years After the PPA, the Path to Retirement Saving Is Easier

[Ten years ago](#), on August 17, 2006, President George W. Bush signed the [Pension Protection Act](#) (PPA) into law, with the goal of ensuring greater retirement security for American workers. With regard to defined contribution (DC) plans, such as 401(k) plans, PPA further encouraged automatic enrollment while paving the way for diversified default investments and the creation of Roth accounts inside DC plans. PPA also made permanent previously legislated contribution-limit increases and the saver's credit.

## PPA Was an Important Stepping Stone for 401(k) Investors

The U.S. retirement system has evolved over time. The Employee Retirement Income Security Act of 1974 (ERISA) created individual retirement accounts (IRAs) and put in place protections around workplace defined benefit and DC plans. In 1981, [regulations for 401\(k\)s were put into place](#), allowing workers to make tax-deferred contributions to DC plans.

Between 1982 and 2001, policymakers changed the contribution limit rules, [substantially reducing the contribution limits to DC plans](#). The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) partially reversed this by increasing retirement-plan contribution limits and introducing "catch-up contributions" for older workers (among other things). Five years later, PPA made permanent many of the improvements introduced by EGTRRA. PPA also introduced another set of significant changes designed to make retirement saving at work easier and more rewarding. These changes made a difference: by the end of 2014, about [55 million workers](#) were active participants in 401(k) plans, and at the end of March 2016, 401(k) plans had [\\$4.8 trillion](#) in assets.

## PPA Made Getting on the Path to Retirement Saving Easier

The first foray into automatic enrollment plan design occurred in 1984, [when a large company introduced the feature](#), recognizing that automatically putting workers on the path to saving was a powerful tool that still allowed worker choice (because workers are allowed to opt out). PPA made it clear to all DC plan sponsors that automatic enrollment is a legitimate plan design feature and that plans implementing automatic enrollment would not run afoul of state wage-garnishment laws. PPA also encouraged adoption of automatic enrollment by establishing a safe harbor from nondiscrimination testing for plans using certain automatic enrollment designs, and a fiduciary safe harbor for the investment of automatic contributions (for more information, see below).

Data from one large DC plan recordkeeper found that automatic enrollment has spread over time, growing to the point where, in 2015, [more than three-fifths of 401\(k\) plan](#)

[participants](#) were in plans that have automatic enrollment. Automatic enrollment has shown itself to be a key tool in increasing participation rates in 401(k) plans, introducing many younger workers to retirement saving.

## **PPA Helped Pave the Way to More Diversified Investing**

Recognizing that retirement savers shouldn't put all of their eggs in one basket, PPA also moved to facilitate diversification of 401(k) investments by generally requiring DC plans to permit participants to diversify out of employer stock, and by giving DC plan sponsors comfort in selecting default options that invest in a mix of asset classes focused on growth and income (rather than using safer short-term vehicles as default investments).

In the latter case, PPA directed the Department of Labor (DOL) to develop guidelines for diversified default investments (the investment option into which a participant's contributions would be placed, in the absence of other investment instructions from the participant) that would receive some protection under ERISA's fiduciary standards. The DOL's resulting guidance said that balanced funds, target date funds, and diversified managed accounts could be used as qualified default investment alternatives (QDIAs).

In the case of target date funds, the plan participant is placed in a diversified fund—investing in a mix of stocks and fixed-income securities—that rebalances over time to be more focused in income and less focused on growth as the fund approaches and passes the target date, which is usually mentioned in the fund's name. The target date is designed to coincide with the year that the participant anticipates retiring.

The first target date mutual funds were introduced in the mid-1990s. Since then, the funds' popularity has risen, reflecting two influences. The first, of course, has to do with their status as a QDIA. The second has to do with the different investment approaches of 401(k) participants. Though some participants are do-it-yourself investors, others prefer to hand the asset allocation management over to an investment professional—which is exactly what a target date fund offers.

401(k) plans cater to a full range of participants and investing styles, [on average offering 27 investment options](#) in the plan lineup. Increasingly, target date funds are among those options. At year-end 2014, 72 percent of 401(k) plans included target date funds in their investment lineups, and 73 percent of participants were in those plans. Nearly half of 401(k) plan participants held target date funds in their 401(k) plan accounts at year-end 2014, and target date fund assets were 18 percent of 401(k) plan assets.

### **Target Date Funds Are Increasingly Offered in 401(k) Plans** **Percentage of 401(k) market; year-end, 2006 and 2014**

Note: Funds include mutual funds, bank collective trusts, life insurance separate accounts, and other pooled investment products.

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project. See ICI Research Perspective, "[401\(k\) Plan Asset Allocation, Account Balances, and Loan Activity in 2014](#)."

## **PPA Opened Up Choice in Tax Planning Inside 401(k) Plans**

[Roth IRAs](#), created by the Taxpayer Relief Act of 1997, gave workers another choice for

their retirement saving needs. With a Roth IRA, a worker can make after-tax contributions and take tax-free distributions after a required holding period. EGTRRA—and, eventually, PPA—extended that tax-planning flexibility into employer-sponsored retirement plans.

EGTRRA included a provision to allow Roth-type investing inside DC plans, such as 401(k) plans, but it did not make the provision permanent and delayed its implementation date until 2006. PPA changed that, making the provision permanent and giving plan sponsors certainty when considering adding such an option to their plans.

PPA also made permanent the [saver's credit](#), which was created under EGTRRA and provides a nonrefundable tax credit for low-income workers who make contributions to employer-sponsored retirement plans and IRAs. Without PPA, the credit would have expired after 2006.

After 10 years, the improvements made by PPA have resulted in stronger, more effective DC plans that enable American retirement savers to prepare for a more secure retirement. PPA was one of many stepping stones in an ongoing journey, facilitating the way forward for plan sponsors, financial services providers, and policymakers to strengthen the country's retirement system.