ETFs: A Potential Solution to a Retirement Problem

Exchange-traded funds are a simple, low-cost alternative for 401(k) plan sponsors to help their participants achieve their retirement goals

Most 401(k) plan participants believe they are behind in their retirement savings, according to BlackRock's 2016 DC Pulse Survey.[1]

This presents challenges for 401(k) plan sponsors. First, participants are expecting their 401(k)s to provide for their retirement. Second, plan sponsors carry the difficult responsibility of selecting the appropriate investments that can deliver on those expectations. Increased scrutiny of retirement platforms creates an added layer of complexity.

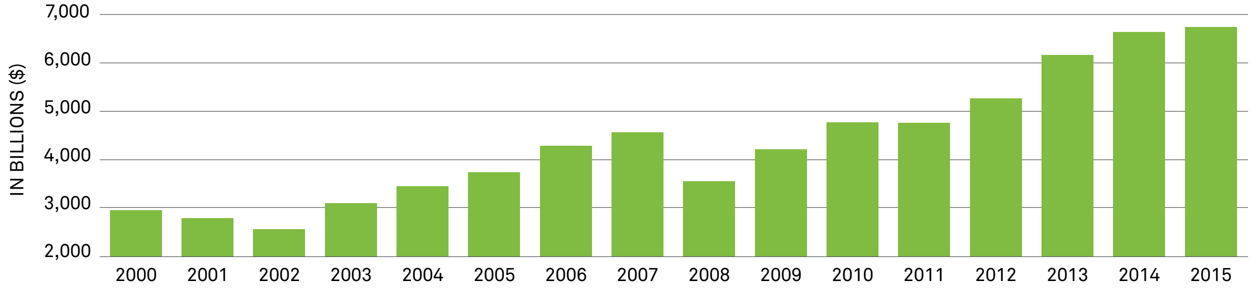
Given the retirement plan challenges that both fiduciaries and participants face, critical features for 401(k) investments are low cost and transparency.

401(k) platforms typically offer both actively managed funds and index funds. Actively managed funds seek to outperform their benchmark, while index funds seek to track the performance of their benchmark. Index funds, such as exchange-traded funds (ETFs), can be simple to understand, transparent and lower cost 401(k) offerings. For this reason, retirement platforms are increasingly including index offerings within their lineup.

Index Investment Trends and 401(k)s

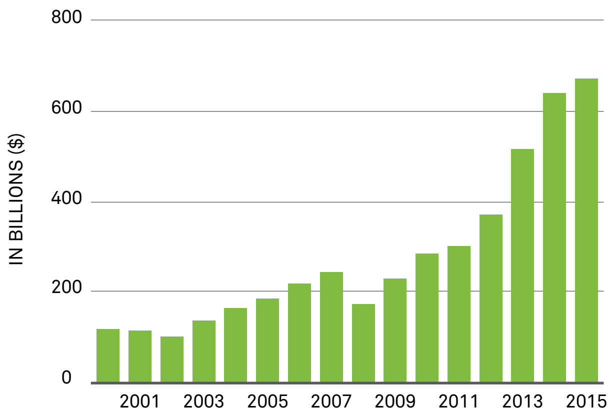
The ascent of exchange-traded funds in the U.S. marketplace has coincided with the growth of index mutual funds on employee-sponsored defined contribution (DC) plans as well as growth of DC plans themselves in the U.S.

ASSET GROWTH OF EMPLOYER-SPONSORED DC PLANS 2000-2015



Source: Investment Company Institute.

ASSET GROWTH OF INDEX FUNDS ON DC PLANS 2000-2015



Source: Investment Company Institute.

ASSET GROWTH OF EXCHANGE-TRADED PRODUCTS

Source: BlackRock.

For certain plan sponsors, choosing ETFs over index mutual funds may have some advantages. Exploring the differences and similarities between ETFs and index mutual funds can help plan sponsors determine which may be appropriate for their participants.

Why Indexing

Both ETFs and Index Mutual Funds Offer 401(k) Participants:

TRANSPARENCY AND CLARITY

- Index funds can offer holdings transparency at the individual-security level that may be publicly available on a daily basis.
- An index fund's performance expectations are clear as the fund seeks to track the performance of the fund's benchmark.

PORTFOLIO BUILDING BLOCKS

- Index funds can offer broad market exposure to asset classes such as equities or fixed income in domestic and international markets.
- In this way, index funds can be simple ways to build diversified foundations for retirement portfolios.

LOWER COST

- Broad market ETFs or index mutual funds, such as those based on the S&P 500 index or the Barclays U.S. Aggregate Bond Index, can carry expense ratios that are over 75% less than active funds in corresponding asset classes.[2]

By being lower cost, transparent portfolio building blocks, index funds—whether in the form of ETFs or mutual funds—may help 401(k) plan participants achieve their retirement goals.

Potential ETF Benefits

Both ETFs and index mutual funds have the potential to help plan participants meet their retirement goals. They both have long-term records of providing investors efficient, low-cost exposure to the market and generally cost less than actively managed funds.

However, ETFs have key features that plan sponsors may want to consider:

- ETFs offer a simpler cost structure than mutual funds, which may have multiple share classes each with different fees and expenses. Each ETF carries just one set of fees and expenses. Defined contribution plans of all sizes deal with the same shares of the ETF.
- Some ETFs can cost less than index mutual funds, and their lower relative cost can act as a subsidy to retirement savings.
- There is a wide variety of indexes that ETFs track, including a large number of market sector, international and commodity indexes.

A 401(k) platform that offers ETFs could provide participants a variety of investment choices to help meet their financial goals.

	ETF	INDEX MUTUAL FUND
Cost	• ETFs and index mutual funds generally cost a small fraction of the average active fund	
Investment Approach	• Seeks to track the performance of an index	
Structure	• Same expense regardless of investment size • No early redemption fees/ minimum holdings periods	• Different expense depending on share class and investment size • Can have early redemption fees/ minimum holding periods
Exposures	• Offers broad market exposures as well as a variety of targeted exposures, including sector and equity style • A wide range of offerings in the international, fixed income and commodity sectors	• Offers broad market exposures, as well as sector and equity style exposures
Transparency	• Offers daily disclosure of the fund's individual holdings	• Offers quarterly disclosure of the fund's individual holdings

ETFs: What to look for under the hood

Knowing how to evaluate ETFs and other index strategies is a growing need as they continue to rise in popularity on plan investment menus. Many plan sponsors may assume that all ETFs and their managers are alike, and often use cost as the deciding factor. However, choosing from the increasing number of ETFs can be much more complicated.

Following are some key questions for plan sponsors to consider:

- How experienced is the manager in developing, managing and supporting ETFs?
- What is the level of the firm's overall investment professional expertise and experience?
- How does the individual fund's performance, net of expenses, compare to other ETFs in its category?
- What benchmark is the ETF tracking? How accepted or widely followed is the index?
- How closely does the ETF track its benchmark?

Want to know more?

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1 Source: BlackRock DC Pulse, 2016. **2** Morningstar as of 12/31/2015.

Carefully consider the Funds' investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Funds' prospectuses or, if available, the summary prospectuses which may be obtained by visiting www.iShares.com or www.blackrock.com. Read the prospectus carefully before investing.

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Investment comparisons are for illustrative purposes only. To better understand the similarities and differences between investments, including investment objectives, risks, fees and expenses, it is important to read the products' prospectuses.

Buying and selling shares of ETFs will result in brokerage commissions.

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