Defined Contribution Institutional Investment Association

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March 11, 2011

Plan Sponsor Survey: Structuring DC Plan Automatic Features to Pump Up Retirement Savings

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Survey Results Highlights

Following the 2010 study "The Impact of Auto-enrollment and Automatic Contribution Escalation on Retirement Income Adequacy," which demonstrated the enormous impact automatic plan features can have on workers' retirement income, the 2011 DCIIA Automatic Features survey examines whether and how plan sponsors are actually implementing these automatic features within their defined contribution (DC) plans. Conducted online among respondents representing 101 large plans, this year's survey documented the actual impact of automatic enrollment on plan participation. Organizations that offer it have increased enrollment by nearly 30 percent above "pre-automatic enrollment" rates. What's more, these organizations said participants who were automatically enrolled viewed automatic enrollment favorably.

Yet, the study also found a disconnect between what sponsors believe are optimal participant savings rates (i.e., 10% or more) and the current automatic default rates, which commonly start at 3% and escalate (when offered) to only 6%. In contrast to the robust rates that plan sponsors advocate, the survey results suggest that the combination of anemic default contribution rates and ineffective adoption of automatic contribution escalation may well mean that auto-enrolled participants are making insufficient contributions to meet their retirement income needs. Although the use of automatic features is headed in the right direction, the survey results beg the question: **Are we going far enough in getting the most out of the automatic features in DC plans?**

Among the key findings in this year's survey:

- Plan sponsors believe participants should earmark at least 10% or more of their earnings for retirement savings.
- Yet, of plan sponsors that have adopted automatic enrollment, more than half have opted for a default savings rate of 3% . . .
- . . . and only about one-third of plan sponsors offering automatic enrollment combine it with automatic contribution escalation.
- While plan sponsors' idea of appropriate savings levels may not mesh with their idea of reasonable default contribution rates, the idea of automatic enrollment itself seems to have gained wide acceptance. The large

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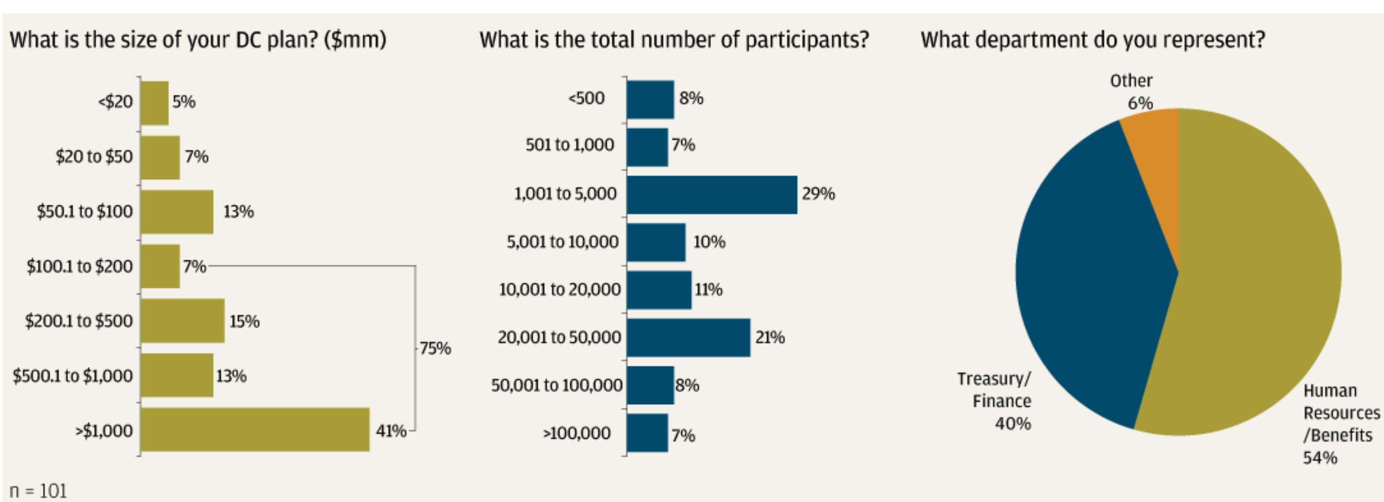
majority of plan sponsors that have adopted automatic enrollment believe participants hold favorable views of the feature.

- The evidence supports their belief and demonstrates the strong impact of automatic enrollment. Respondents reported plan participation rose by nearly 30 percent above "pre-automatic enrollment" rates.
- Despite the apparent success of automatic features, the large majority of plan sponsors that have not already adopted them do not plan to do so in the next 12 months.

Survey Background and Respondent Snapshot

The Research and Survey Committee of DCIIA conducted the Automatic Features survey in late 2010 among 101 respondents representing a broad cross-section of DC plans:

- The majority (72%) of plan sponsors reported that 401(k) plans serve as their primary retirement vehicle. Another 14% offer 457(b) governmental plans and the remaining 14% offer 403(b) or 401(a) plans.
- Three-quarters of the respondents represented plans with assets greater than $100 million and 86% of the plans had more than 1,000 employees.
- Although most of the respondents—54%—represented plans covering workers in manufacturing, government or financial services, the balance was widely diversified among 14 additional industry classifications.
- Human resources professionals made up the bulk of the respondents (coincidentally, 54%) and 40% came from either finance or treasury functions.



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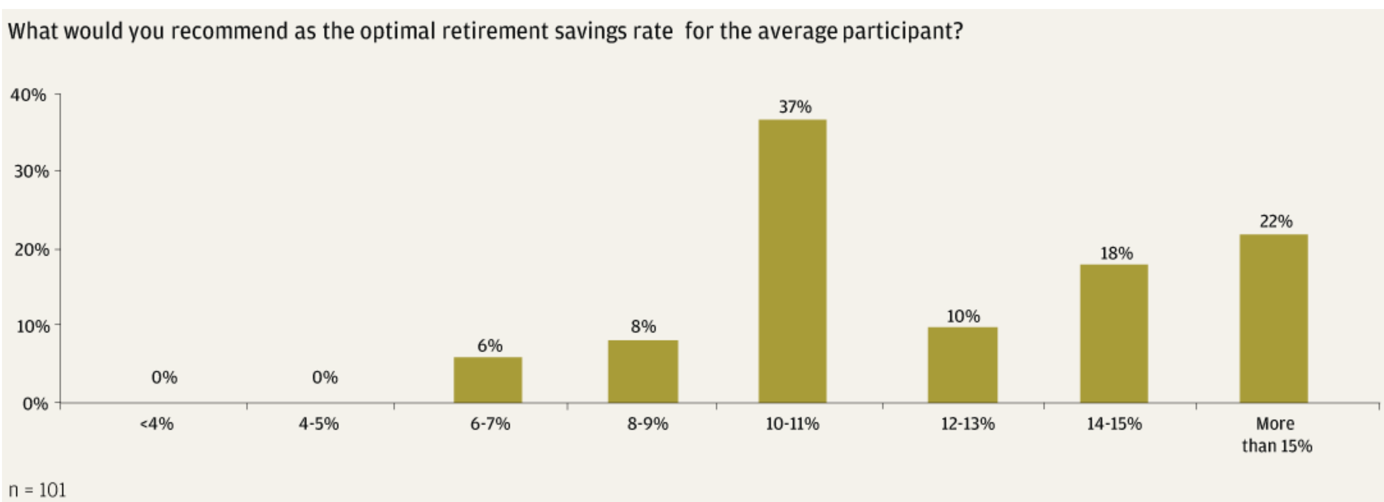
Plan Design and Optimal Savings Rates

While there is much discussion in the industry regarding the optimal retirement plan design, there is broad consensus that one of the most important contributing factors to success is participant savings levels. We wanted to learn from plan sponsors how they think about participant savings rates—"how much is enough"—and whether and how they designed plans to achieve that rate.

All respondents, regardless of their specific job function, recognized the importance of sufficiently high savings rates to provide a secure retirement. When the survey queried the "optimal" participant savings rate, only 14% recommended a rate of less than 10%. Nearly four out of ten would recommend between 10–15% (before any company match), and more than a fifth of the respondents would recommend a saving rate of more that 15%. Notably, 48% of the HR/benefits professionals specified a rate of 15% or higher, versus 32% of finance/treasury respondents.



Addressing at least partially the difference between current default contribution levels and optimal savings rates, nearly 80% of DC plans offer some type of matching contribution, about 70% in a fixed or formula match. Only 6% of the plans surveyed provide a profit sharing or discretionary match. Half of the plans offered a non-matching employer contribution.

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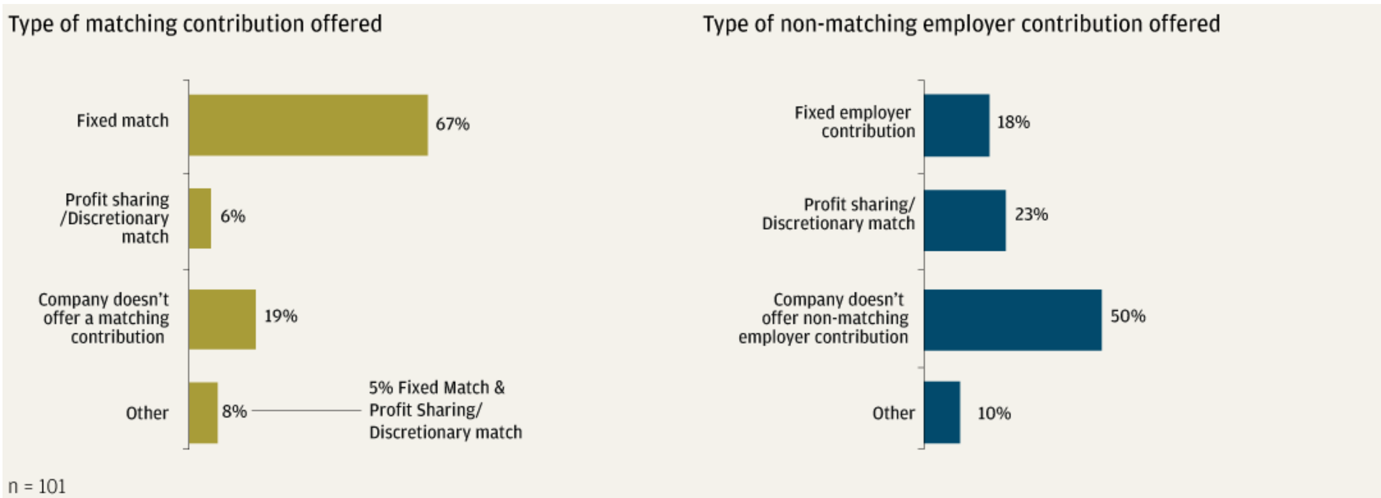
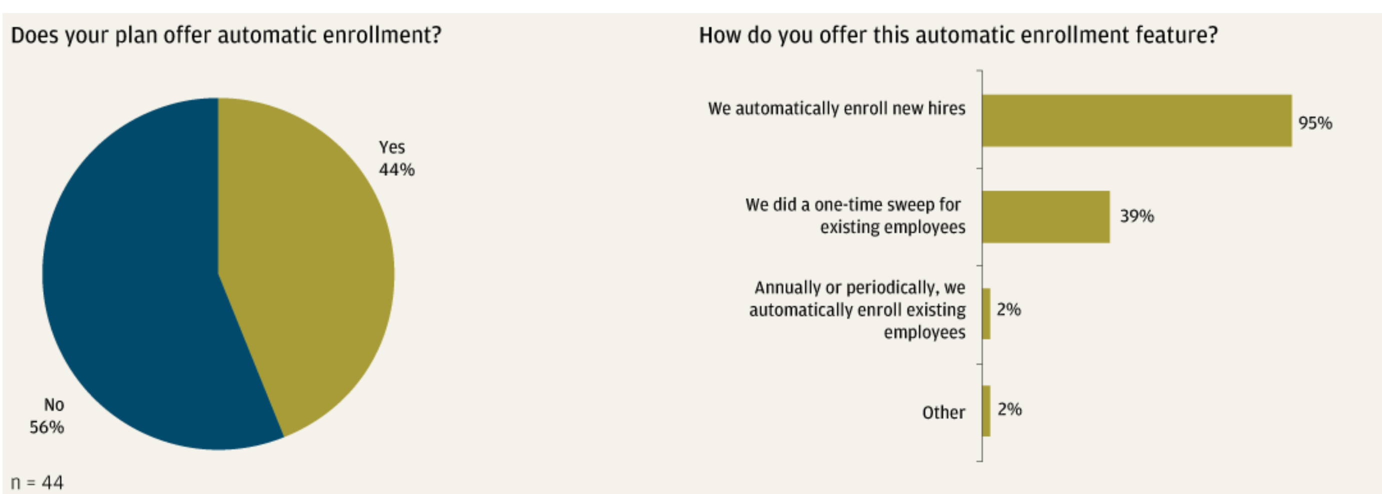


Automatic Enrollment Adoption and Design

Consistent with numerous other surveys, the DCIIA Automatic Features survey found that automatic enrollment is fairly commonly used in DC plans—close to half of plans (44%) automatically enroll eligible employees. Employers offering traditional pension plans are least likely to enroll participants automatically, as are plans that don't offer a matching contribution. Most plans don't conduct ongoing periodic automatic enrollments for existing employees; however, 39% of the plans with automatic enrollment have performed a one-time sweep of existing nonparticipants into the plan. With an emphasis on automatic enrollment for new hires only, it may take certain companies years before the full impact of automatic enrollment plays out in terms of significantly higher DC plan participation levels.



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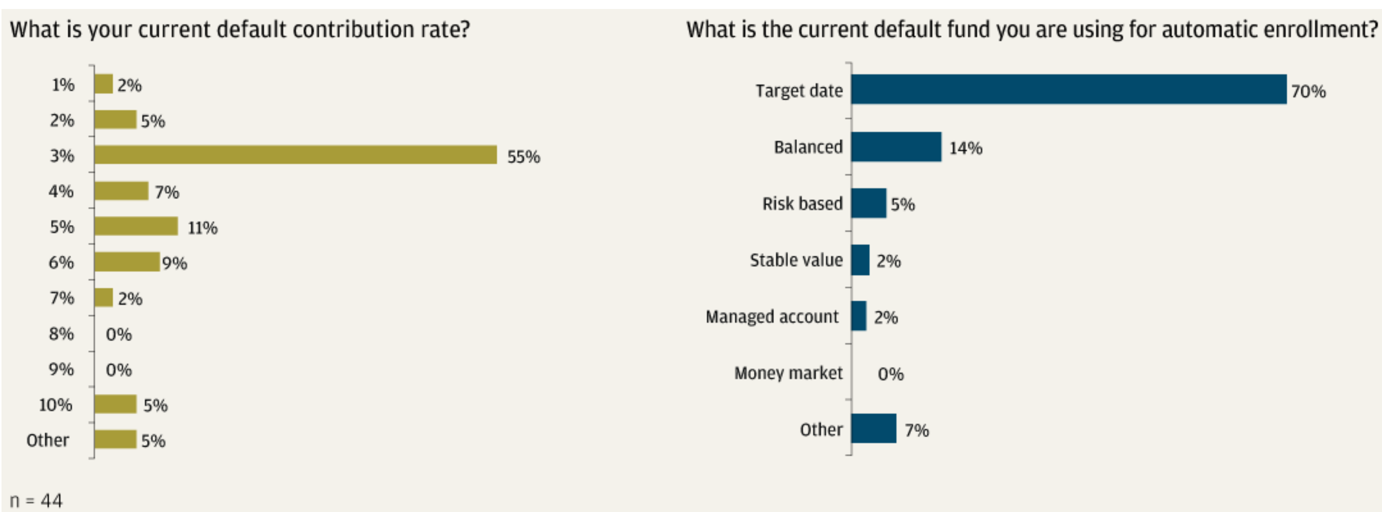
Inertia: Friend and Foe of Automatic Enrollment

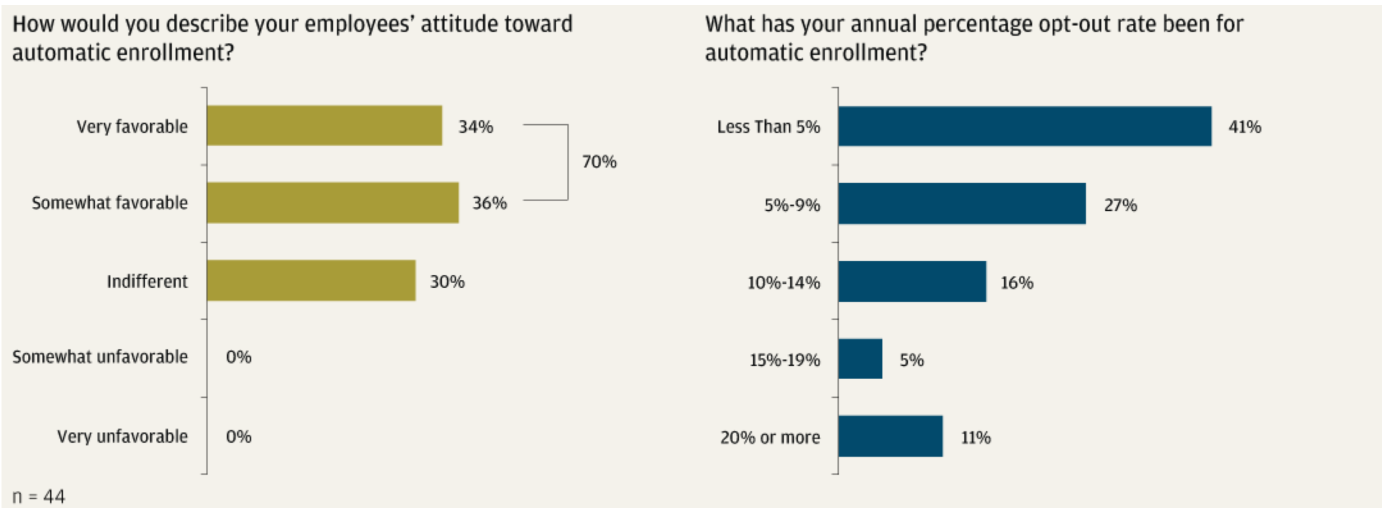
The most common default contribution rate under automatic enrollment is 3% of pay, favored by more than half of the plan sponsors in our survey. The figure is clearly at odds with the level at which the sponsors believe participants should save, a figure most respondents pegged at 10–11% or more. Conversely, conservative default investment funds such as money market or stable value, are far from the norm. Seven out of ten plans use target date funds as their default investment option, followed distantly by balanced and risk-based funds.

Thus, the well-documented inertia that characterizes employee behavior when it comes to retirement saving is a double-edged sword in the prevailing automatic enrollment environment. Automatically enrolled participants will likely remain stuck at inadequate savings levels for years due to low default deferral levels. That said, due to the common use of target date funds as defaults, employee savings will be well diversified and strategically rebalanced.



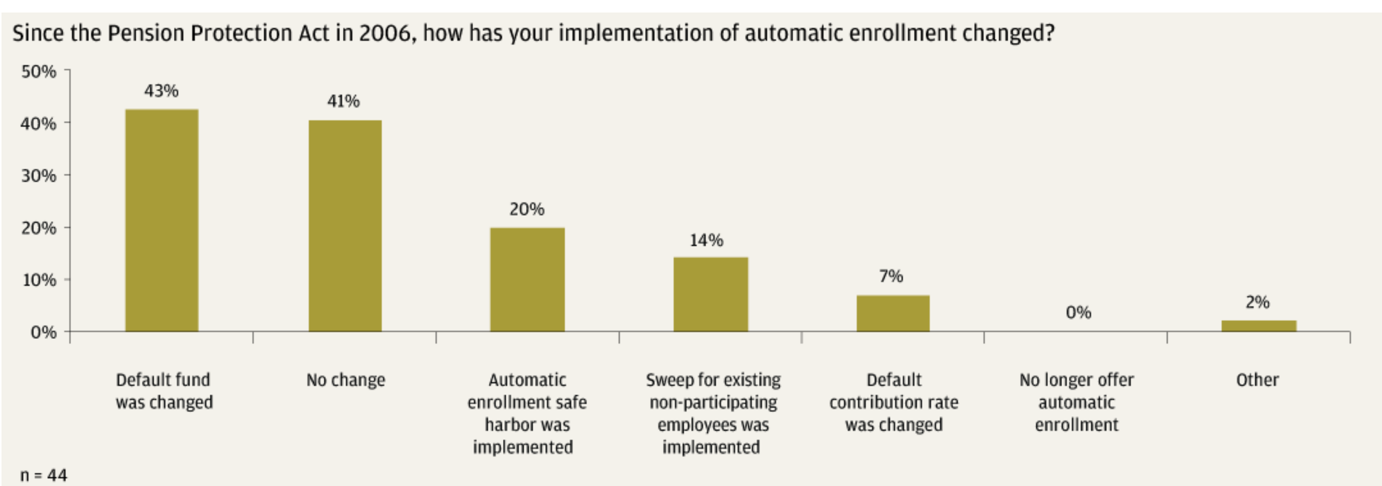
Measures of Participant Satisfaction

Two-thirds of the automatic enrollment plans in the survey had employee opt-out rates of 9% or less, with four in ten reporting rates below 5%. This translates into substantial gains in the participation rate of automatic enrollment plans, with respondents reporting that participation increased from 63% to 81% since automatic enrollment was implemented. Inertia likely explains much of the success of automatic enrollment. However, more than simple inertia, the survey found that a large majority of plan sponsors believe employees view automatic enrollment favorably. Further, according to respondents, participant perception of automatic enrollment was not influenced much by the level of default deferral rate that was implemented (e.g., 3% versus 6%).



The Impact of the Pension Protection Act on Automatic Enrollment

Although more than one in four plan sponsors reported that they made no change to the implementation of automatic enrollment since the passage of the 2006 Pension Protection Act (PPA), the Act prompted changes among the majority of automatic enrollment plans in our survey. Most commonly, plan sponsors reported switching the default fund primarily to target date funds. One in five plan sponsors with automatic enrollment indicated that they had implemented the automatic enrollment safe harbor since the passage of the PPA. In contrast, changes to the default contribution rate, at only 7%, were rare.



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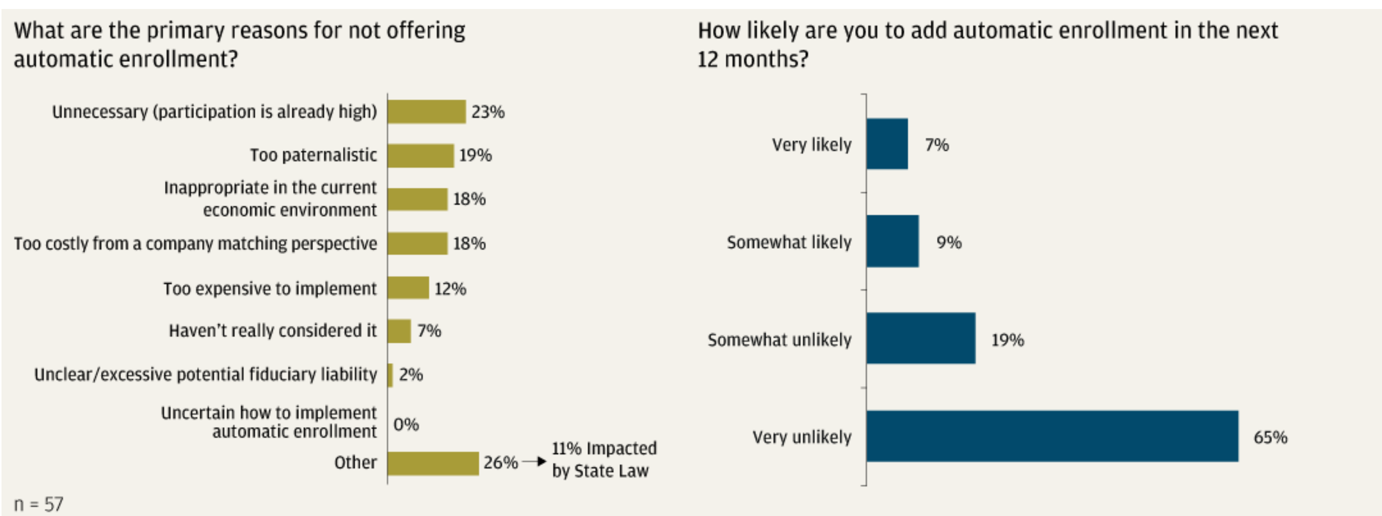
The (Near-term) Future of Automatic Enrollment

Plan sponsors that do not already automatically enroll participants don't plan to do so in the next 12 months—65% of plan sponsors represented in the survey said it was very unlikely; another 19% said it was somewhat unlikely.

The largest number of negative respondents indicated that they saw no need for automatic enrollment due to already high levels of participation. Others felt automatic enrollment was too paternalistic, inappropriate in the current economic environment or simply too costly from a company matching perspective.

Interestingly, despite the protection from state wage law restrictions afforded by the PPA safe harbor, one in ten plan sponsors cited state wage law issues as a reason for failing to implement automatic enrollment. This may reflect the fact that not all DC plan types are covered under the PPA.



Adoption and Design of Automatic Contribution Escalation Programs

Automatic contribution escalation features have become fairly common as well, with 46% of the plans in the survey offering them in some form. The plans that offer the feature typically offer it as an "opt-in" strategy. About a third of plans with automatic contribution escalation offer it in tandem with automatic enrollment—increasing the likelihood that those who are automatically enrolled will reach adequate deferral levels over time. For the most part, the PPA had little effect on the implementation of automatic contribution escalation, although a significant minority—11%—switched from the proactive opt-in mode to the opt-out default.

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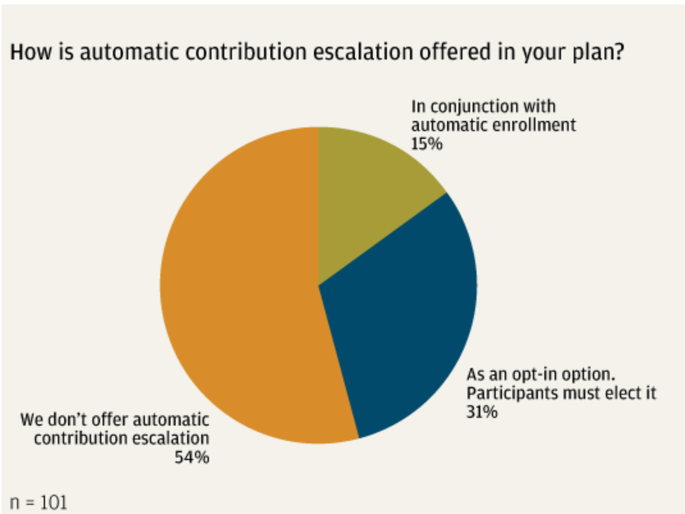
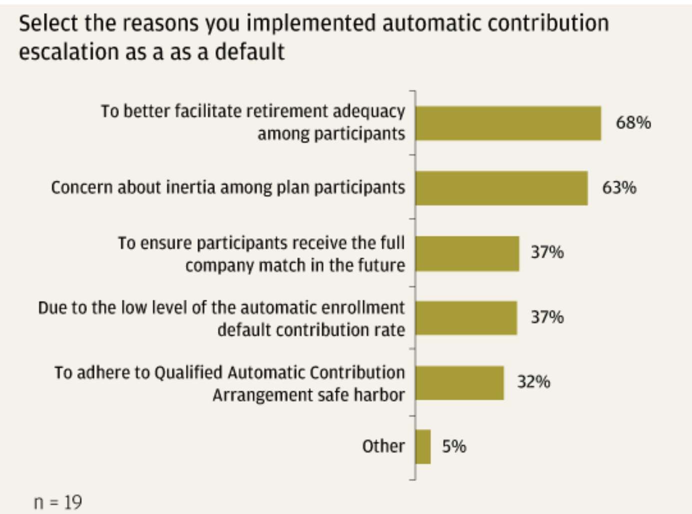
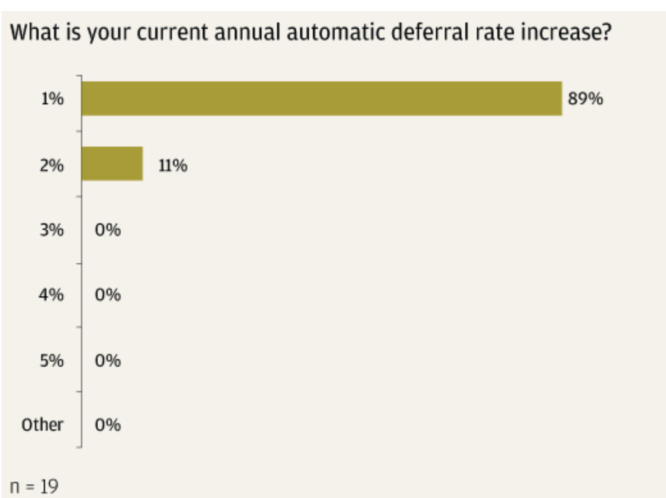
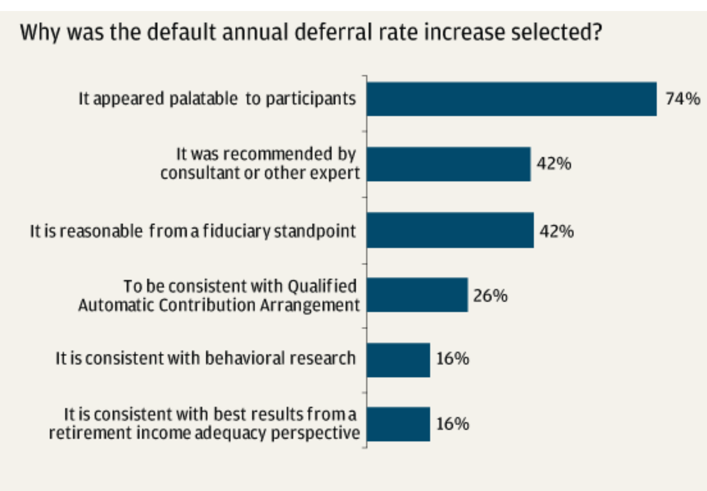
Among plan sponsors that use automatic contribution escalation as a default, most report doing so in response to concerns over retirement adequacy (68%). Concerns about participant inertia checked in at a close second (63%), indicating awareness that without automatic contribution escalation, it can be difficult to coax plan participants into increasing their deferral rates.





Plan sponsors feel that most participants are indifferent at best about automatic contribution escalation as a plan feature. Perhaps as a result, nine out of ten default plans keep the escalator to a minimum—1% per year—a figure that three-quarters of plan sponsors believe their participants find "palatable." At the same time, few plan sponsors agreed that such a low escalation rate was likely to be consistent with the best results from a retirement income adequacy perspective.





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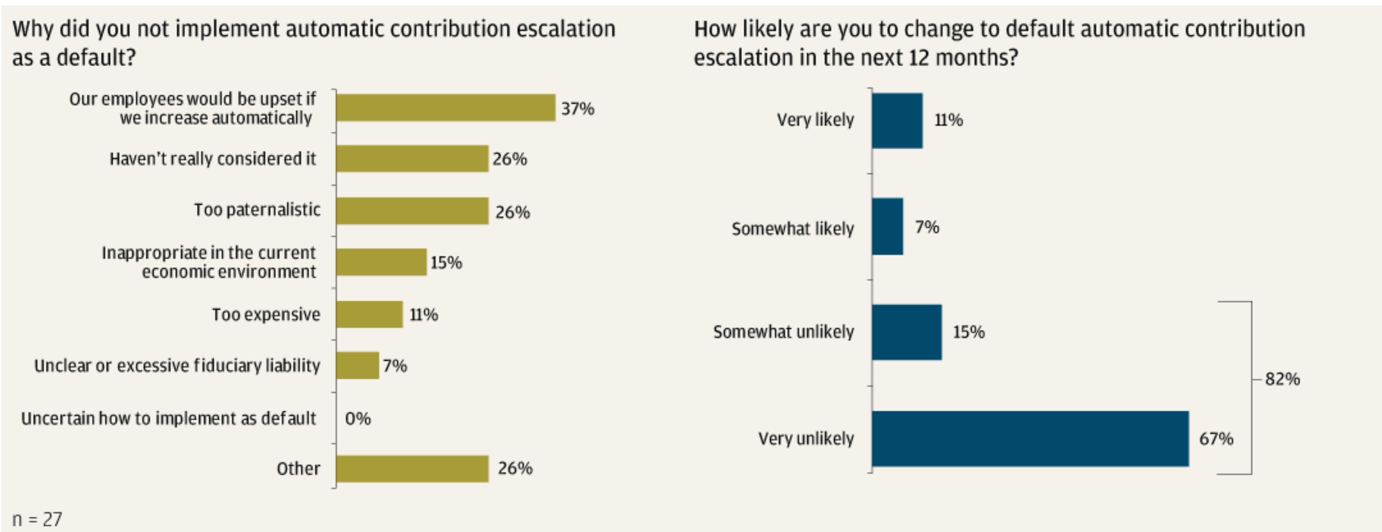
The lukewarm reception of automatic contribution escalation also may explain why the overwhelming bulk of opt-in plans—82%—won't be changing to opt-out in the foreseeable future or, for many in the group, ever. While a quarter of the opt-in group has never even considered the change, those that have considered it worry that employees would object to an automatic increase in withholdings or would see the move as overly paternalistic.



Communication Strategies and Plan Objectives

Most plan sponsors in the survey rely on their recordkeeper's standard communications package to inform participants about a plan's automatic features. Communications approaches diverge, however, when it comes to automatic enrollment versus automatic contribution escalation. Twenty-seven percent of the plan sponsors customize their automatic enrollment communications, compared to just 15% for the automatic contribution escalation.

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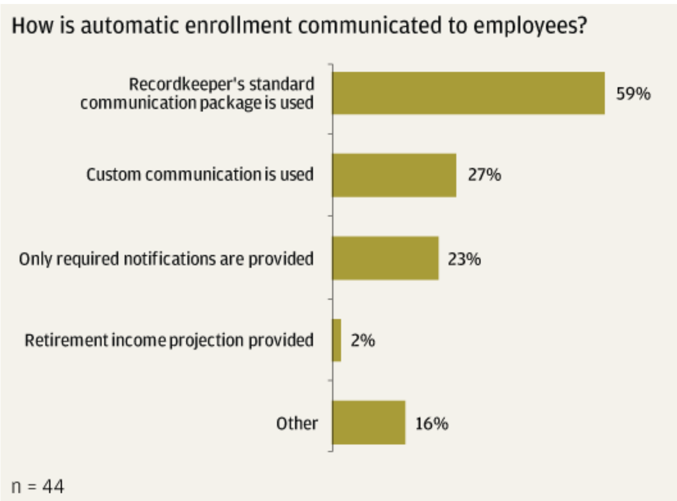
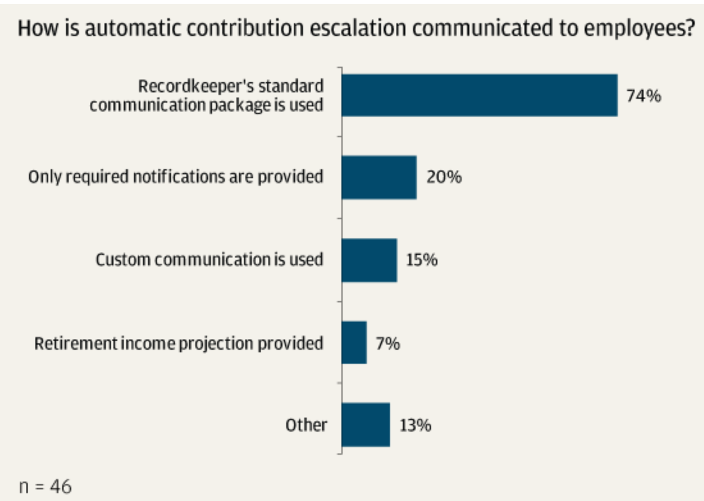
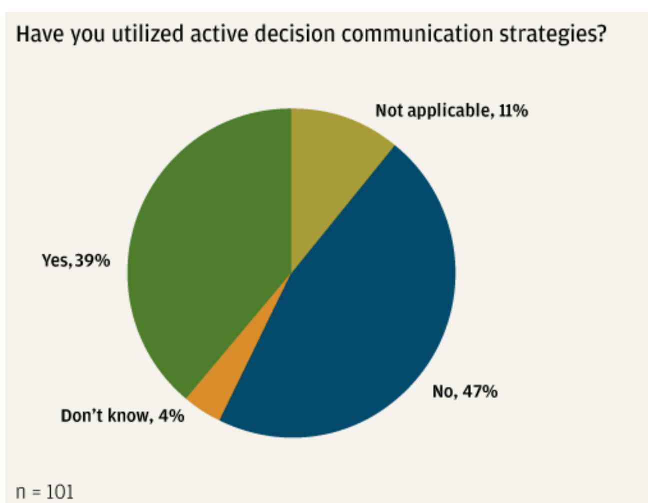




Four in ten plan sponsors surveyed report using active decision communication strategies (i.e., postcards and emails) to trigger easy check-the-box changes to deferral rates, whether or not their plans have automatic features. It is far more common for plans that have automatic contribution escalation to utilize active decision communication strategies (51% versus 25% who don't). This either demonstrates the high priority these plan sponsors place on increasing deferral rates or their comfort level with proactive solutions.



Increasing participation rates was cited most frequently as the most important objective of the plan by DC plan sponsors, followed by improving education efforts and increasing savings rates. Among plan sponsors that rank increasing participation as their highest priority, increasing savings rates ranks as the second highest priority. Only one in four plan sponsors not

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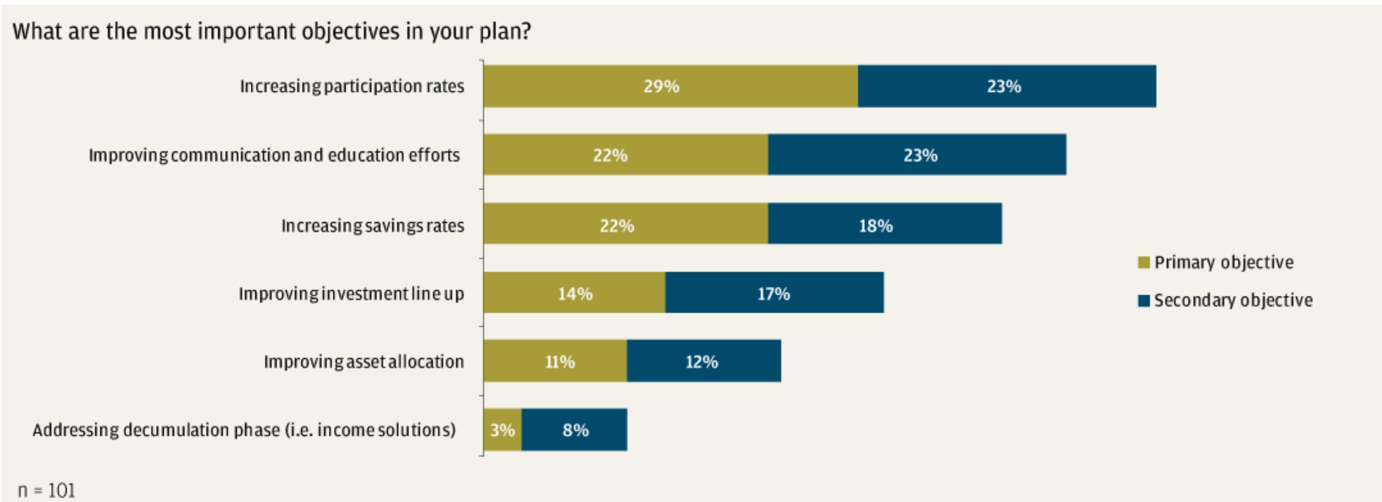
offering automatic enrollment ranked increasing participation rates as a top priority, suggesting that many plan sponsors that do not have automatic enrollment do not see the need for it because they are not prioritizing higher participation.



The Re-enrollment Strategy

It's clear that there is widespread misunderstanding of the concept of plan re-enrollment. A re-enrollment requires plan participants to make new investment elections. Otherwise, the plan will invest their existing assets and future contributions in the plan's default option, typically a target date fund. Implementing this type of strategy can quickly enable a plan to improve overall asset allocation. One in six plan sponsors have not considered re-enrollment either because they were not familiar with the concept of plan re-enrollment or they weren't aware of it as an option.

Only 6% of the plan sponsors surveyed have conducted a plan re-enrollment campaign. Respondents offered a variety of reasons for not utilizing this strategy. They cited four objections in particular:

- Participants already were experiencing too many changes in the plan (14%)
- The sponsor couldn't see the benefit (12%)
- The sponsor couldn't get investment committee approval (11%).
- The largest share of answers (36%) reported that plan sponsors simply have not considered conducting re-enrollment because they already feel comfortable with the overall asset allocation of their participants.

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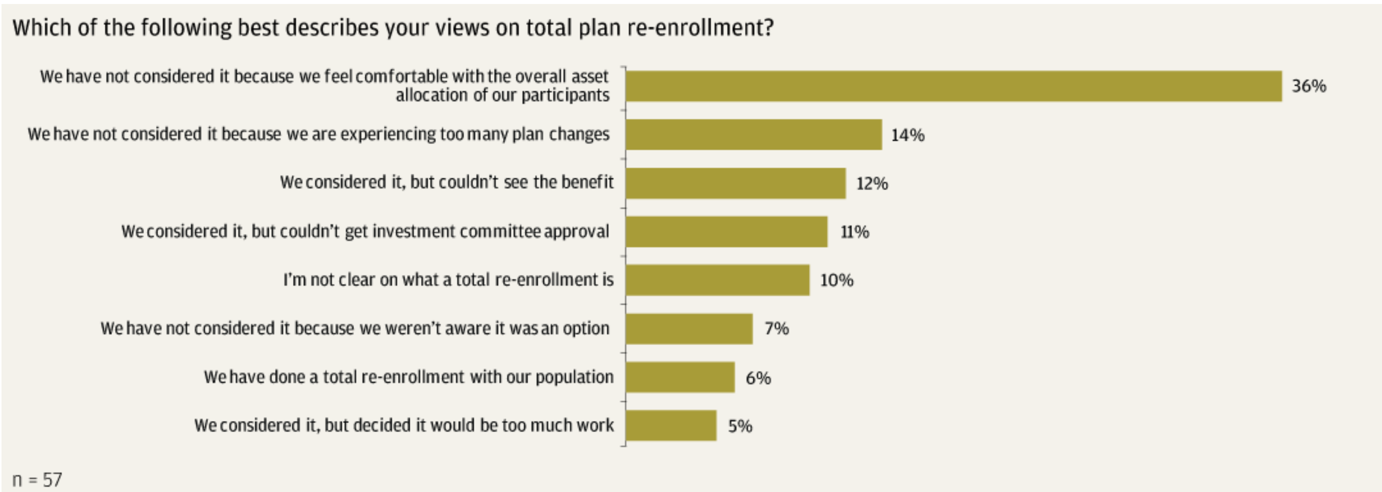

Summary

Defined contribution plans have come far since the adoption of the PPA. Automatic enrollment has significantly boosted participation, and employees generally view it as a distinct benefit. The fact that, despite the progress, many plans' automatic features are not designed to drive contribution rates high enough to secure participants' retirements suggest the next big item on the plan sponsor agenda. So does the fact that automatic contribution escalation is not perceived to enjoy anywhere near the acceptance among participants that automatic enrollment does. The two facts combine to create a contribution gap that is looming as large today as the participation gap just a few years ago. Plan sponsors need now to devise strategies as effective in raising contribution levels as automatic enrollment has been in raising participation rates.

For plan sponsors seeking to raise participation and savings rates, DCIIA suggests implementing automatic enrollment along with automatic contribution escalation. Our studies support defaulting employees (whether new hires or non-participating employees) into the plan at the match rate and then escalating contribution rates by 2% annually to reach at least a 10% savings level as rapidly as possible.

Note: Some percentages in the survey results do not total 100% due to rounding.

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About DCIIA
The Defined Contribution Institutional Investment Association (DCIIA) is a non-profit association dedicated to enhancing the retirement security of American workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution plan design. DCIIA members include investment managers, consultants, law firms, recordkeepers, insurance companies, plan sponsors and others committed to the best interests of plan participants.

DCIIA's mission is underpinned by five core beliefs:

- The primary role of defined contribution retirement plans is to create retirement income adequacy: Helping plan participants build sufficient savings to achieve their goals while working (accumulation) to support their income needs in retirement (distribution).
- Well-designed default programs can improve retirement outcomes: Automatic enrollment and automatic contribution escalation (of participant contribution levels), when combined with default investment options that take advantage of institutional asset management techniques, help increase savings levels and promote better retirement outcomes.
- The regulatory framework and industry infrastructure must offer full support for all types of institutional investment approaches and products, giving defined contribution plans access to the complete toolkit of investment, retirement income and advice solutions.
- Plan sponsors and their consultants should have the ability to select the best combination of partners to meet plan needs, including investment and retirement solutions, record keeper, custodian, managed account, advice and other service providers.
- Full transparency on pricing and revenue sharing is critical for plan sponsors to evaluate the optimal combination of solutions to deliver improved retirement outcomes for their participants.

To further its mission, DCIIA:

- Aims to make it simpler for defined contribution plan sponsors to implement appropriate institutional investment management approaches in DC plans focused on delivering higher returns and reduced risks;
- Provides an independent forum for thought leadership on advancing defined contribution and retirement income design, including institutional default investment strategies and retirement income solutions;
- Conducts research, publishes analysis and insights and hosts events that support the advancement of institutional approaches and better defined contribution design;
- Identifies and removes barriers for plan sponsors so that they may pursue improved defined contribution institutional investment structures;
- Encourages improved fiduciary practices and tools to support institutional defined contribution plan design; and
- Educates legislators and regulators about issues and challenges in institutional defined contribution plan design and better approaches to retirement security