COMPLIANCE

SEVEN ATTRIBUTES OF AN EXCELLENT DEFINED CONTRIBUTION PLAN

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Plan sponsors and advisors commonly benchmark their plans to industry averages, but is average what we should be striving for? Especially in an industry that most observers suggest needs improvement?

Average DC plans often have insufficient participation, low savings rates, poor participant diversification, murky fee disclosure, and too many investment options that aren't of institutional quality. When stated this way, average might not sound like such a good benchmark. In every aspect of our lives, we strive for excellence. We believe DC plans should strive for excellence, as well.

The good news is we have a pretty clear idea of what we believe needs to be done to achieve plan excellence. Here are key attributes that all excellent DC plans share and the actions you can take to help make sure your plan is positioned for excellence.

ATTRIBUTE NO. 1: A RETIREMENT INCOME MINDSET

First, change the attitude of participants.

Average Plan: Each quarter, plans report current account balances to their DC participants; in fact, Department of Labor guidelines require it. Plan sponsors monitor how much participants have saved. The average balance is around $71,000. While most plan sponsors know this isn't enough, their participants may have no way of knowing where they stand in terms of their retirement readiness. Imagine packing for a vacation without knowing your destination. How would you be able to plan for what you need? Retirement participants who focus only on their balances are faced with that issue.

Excellent Plan: Excellent plans provide gap analysis disclosure or a statement with retirement income projections to participants as a standard part of their reporting. This helps participants better understand their retirement readiness and set the right savings rate.

Action Items: Develop a Target Replacement Income (TRI) goal for the plan and design default and company match rates with this TRI in mind. Work with your recordkeeper to enhance your plan's statements to take the focus away from wealth accumulation and place it on retirement income. Excellent plans of the future may include post-retirement products, such as annuities and other payout approaches.

ATTRIBUTE NO. 2: A THOUGHTFULLY DESIGNED PLAN MENU

Streamline "Tier II" and make it simple.

Average Plan: The median plan still offers 22 options (13 if you count only Tier II, or single-asset-class offerings), with 26 percent of plans offering a brokerage window for expanded choice. Great strides have been made to reduce the number of menu options but there is still a legacy from the 1990s, when the prevailing trend was to demand more choice. The average plan is trimming investment options at the margins, but not making wholesale menu design changes.

Excellent Plan: An excellent plan profiles the participants they're trying to serve in each tier of the investment menu. There are three typical profiles: do it for me, do it with me, and I'll do it myself. We recommend plans use a three-tiered structure designed to satisfy each profile. This "choice architecture" allows a participant to easily identify with a profile and pick from the respective tier.

For the second tier (do it with me), offering a limited set of options (five to eight) aids participants' allocation and decision-making. To achieve this, excellent plans are collapsing options into major categories or providing premixed risk-based allocations. For example, instead of growth, core, and value large-cap equity fund options, they're combining these choices into a single, diversified large-cap option, allowing "do it with me" participants to tailor their allocations to their needs and beliefs.

Action Items: Identify participant profiles and design a menu to satisfy different profiles' needs. Consider offering a limited number of broad multi-manager and multi-style funds as core options. To provide more choice for the minority who demand it, consider offering a brokerage window.

ATTRIBUTE NO. 3: BEST-OF-BREED INVESTMENTS

Move outside the recordkeeper's "box."

Average Plan: In 2008, 55 percent of all DC investment assets were affiliated with the recordkeeper. This is a vestige of the early days of DC, where generous revenue sharing arrangements or proprietary requirements gave plans an incentive to pick their recordkeepers' funds. Plan sponsors need to realize that they're able to move away from this structure and use only managers they believe to be the best.

Excellent Plan: We believe an excellent plan makes decisions on the funds to offer, including target date funds, based on investment merits and analysis. An excellent plan understands that no one provider can be best in all asset classes. Providing the best available investment options and structures to participants is more likely to lead to better outcomes.

Action Items: Use the upcoming DOL fee disclosure regulations to separate investment fees from administrative fees and evaluate the fairness of how participants pay for administration. Move to provide the best available investment options and formats to participants.

ATTRIBUTE NO. 4: APPROPRIATE PARTICIPANT DIVERSIFICATION

Be a guide to your participants.

Average Plan: The typical plan has just 8.2 percent of plan assets in a target date fund and only a handful of participants making use of managed accounts. Up to 18 percent of plan assets are in company stock and 13 percent are in stable value options. Also, many participants don't appear to have an appropriate allocation relative to their years until retirement.

Excellent Plan: An excellent plan has 60+ percent of participants in an asset allocation strategy (target date, balanced, or managed account). This is the minimum allotment we see in plans whose participants are defaulted into such strategies, either upon enrollment or re-enrollment. Many plan sponsors have embraced asset allocation default solutions, such as target date funds, for new employees. Excellent plans have also realized that legacy participants' investment allocations may not be the most appropriate.

Action Items: Consider a re-enrollment campaign to follow your menu re-design. This provides current participants with an opportunity to find the right investments to fit their profile, stay with their original allocation, or be defaulted into the plan's Qualified

Default Investment Alternative (QDIA). Give both short- and long-tenured participants the same opportunity to benefit from appropriate asset allocation.

ATTRIBUTE NO. 5: EFFECTIVE EMPLOYEE EDUCATION

Focus on financial education.

Average Plan: Though often used interchangeably, financial education and investment education are different concepts. An average plan may address both, but will be more focused on investments and asset allocation concepts, rather than retirement planning and saving concepts. In fact, some retirement education can actually cause participants to disengage from the process. Imagine taking your watch in to be repaired and being given instructions on how to repair it. The vast majority of participants aren't looking to become investment experts; they're looking for tools to provide them with answers.

Excellent Plan: Excellent plans understand that many participants lack basic financial literacy. Instead of teaching participants to be investment experts, they focus on how to help participants develop an overall financial plan for retirement and how to successfully use the tools available to them to implement one. Primarily, participants need to know how much they need to save for retirement, what that will equate to in terms of income at retirement, and if they're on track to reach their objectives.

Action Item: Provide your participants with financial education that focuses on helping them determine their investment type and guides them to the correct tier on the plan's investment menu. Be sure to incorporate tools that put the focus on a retirement income mindset. Design your education and communications on how to establish a retirement income goal and work backwards to what participants need to save to meet their desired goals. Then, provide them with regular updates on progress, like a gap analysis, so they can adapt to changing circumstances as needed to stay on track.

ATTRIBUTE NO. 6: HIGH CONTRIBUTION RATES

Give participants the best chance of success.

Average Plan: The single biggest factor in participants' success is their savings rate. Most plans receive a yearly report on participant savings rates from their recordkeeper, and the average deferral rate is about 6.8 percent. Knowing that the savings rate is "about average" won't help your participants achieve their goals, especially when the average savings rate is too low.

Excellent Plan: Per Attribute No. 1, plans that focus on the retirement income mindset can define participant success in terms of a specific Target Replacement Income (TRI) goal. Russell's research shows that to achieve a high degree of certainty around a TRI goal, your participants will likely need to save 10 percent or more of their salary, in addition to an employer matching contribution. Excellent plans use many tools to help achieve this goal including: save more tomorrow (auto-escalate), the company contribution formula to incentivize higher savings, targeted campaigns, and education that's focused on savings behavior.

Action Item: Determine a targeted savings rate. Structure the company contribution formula and plan communications around these ideas. Consider using tools such as higher default rates and auto-escalation to ease participants into the retirement income mindset and successful savings behavior.

ATTRIBUTE NO. 7: HIGH PARTICIPATION RATES

Get everybody involved.

Average Plan: Participation rates around 70 percent to 74 percent have been prevalent for the past six years. Odds are your plan is similar. An average plan will help to move the needle over time, but fall short of increasing participation by more than a percent or two each year.

Excellent Plan: Strive for participation rates above 90 percent. Making the jump from average to exceptional takes fortitude and proactive persistence. For excellent plans, auto-enrollment is one way of overcoming participant inertia, but more important, stay tenaciously focused on increasing, attaining, and sustaining high participation rates. Excellent plans know that the right financial education combined with a well-designed plan can make all the difference.

Action Plan: Decide if auto-enrollment is right for your plan. If you already use auto-enrollment, consider doing a complete re-enrollment during your next open enrollment cycle. Finally, if you have recently done both, use targeted easy enroll (one click/check) campaigns.

CONCLUSION

In every aspect of our lives, we strive for excellence. In this article, we've described seven attributes of excellent plans. But you'll notice that excellent plans don't happen by accident; it takes a process starting with the end in mind, combined with fortitude and persistence, to achieve excellence. We've laid out several steps you can take this year to help move your plan from average to excellent. PC

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ATTRIBUTE	AVERAGE PLAN	EXCELLENT PLAN	CORRECTIVE ACTION
Retirement income mindset	Focuses on account balances	Has embraced a retirement income mindset	Set Target Replacement Income (TRI); design your plan communications around it and measure success. Approach your recordkeeper and other service providers to assist you in incorporating the right tools into your plan.
A thoughtfully designed menu	Trims options at the margins	Thinks about the delivery of options to meet participant investment types	Consider a move to a three tiered structure. Offer target date funds for the tier I majority. In tier II, collapse options like growth and value into one offering and offer broad multi-manager and multi-style funds.
Best in class investment offerings	Offers proprietary and single-manager solutions	Embraces open architecture, best-of-breed investment options	Explore the open architecture options available to your plan. Separate investment and admin fees; engage in a detailed evaluation of your investment options.
Participant diversification	Small percentage of the plan invests in target date funds	Strives to find ways to increase the percentage of participants in an asset allocation strategy	Conduct a re-enrollment campaign as you update your plan menu. Help participants diversify by defaulting those who don't take action to the appropriate target date fund.
Employee education	Focuses on investment education	Focuses on financial education and retirement income goals	Utilize your tiered menu to help participants develop a plan. Work with your recordkeeper to provide participants with information on their retirement income so they can work backward and determine the right savings rate.
Savings rates	Settles for a 6-7% employee savings rate	Utilizes auto features to drive savings rates greater than 10%	Use the TRI you determine for your plan to design your auto features and drive your communications plan.
Participation	Has fallen into a participation rut of 70-74%	Strives for 90%+ participation	Review your plan features to ensure you are utilizing your auto features to their full extent. Consider re-enrollment.