SPECIAL OUTCOMES ISSUE

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How plan advisors are helping plan sponsors focus on retirement outcomes

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THE OUTCOMES ISSUE

COVER 38

Retirement Ready—or Not?

by Judy Ward

How plan advisors are helping plan sponsors focus on retirement outcomes.

SECTIONS

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The End in Mind

I don't remember when I first read Stephen Covey's *The 7 Habits of Highly Effective People,* and honestly I only remember two of them. One, "sharpen the saw," has stuck with me mainly because it always struck me as an odd statement. The other, and one that I have found myself citing repeatedly over the years, is to "begin with the end in mind."

However wise that admonition, it wasn't on my mind when I began saving for retirement. Rather, I took to heart the notion that I shouldn't miss out on the "free" money of the employer match — and saved that amount from the time I was first eligible to save in a workplace retirement plan.

Now, as things have turned out, I always had access to a DC plan, and, despite varied matching formulas, each of my employers has always matched to at least the 6% level of deferrals. But I was well into my working — and saving — career before I sat down to figure out whether that level of saving would be "enough."

I suspect my experience is pretty common among those who saved before the "new" era of automatic enrollment designs — well, except that surveys suggest that most still haven't tried to figure out how much they would need, and if their level of saving will put them within sight of that goal.

Today, Americans are arguably better positioned than ever to attain such goals. More people have access to a workplace plan that ever before, and most of those who do no longer have to wait a year to be eligible to participate. Automatic enrollment gets more people started earlier, and if the starting deferral rate is less than optimal, devices such as contribution acceleration are at hand to help close the gap.

> "Surveys indicate that more individuals than ever have access to, and seek out, the counsel of trained retirement plan advisors."

Perhaps just as significantly, qualified default investment alternatives are creating a whole new generation of savings accounts that are not only more diversified, but also are rebalanced on a regular basis by investment professionals. Moreover, surveys indicate that more individuals than ever have access to, and seek out, the counsel of trained retirement plan advisors.

That said, those automatic structures, helpful as they surely are, may well have the unintended effect of insulating individuals not only from the need to make these decisions, but also from an awareness of the consequences of those decisions — despite an emerging array of online projection tools and presentation of monthly income figures on participant statements.

Arguably, the responsibility rests with the individual saver, but if left unaddressed, the burden may fall on already strained social services. In a "best case" situation, individuals who have not made adequate preparations for retirement may simply seek to extend their working careers, with enormous cost and workforce management issues for employers and workers alike.

Enter the relatively new industry focus on outcomes, and this special issue on that subject. On the pages that follow you'll find contributions from a wide variety of thought leaders at NAPA Firm Partners covering a broad range of innovative tools, approaches and insights on ways to help improve plan, and participant, outcomes. Additionally, our cover story, "Retirement Ready — or Not," looks at how retirement plan advisors are working with plan sponsors on the issue of outcomes — and the objections and questions they are confronting along the way.

Let's face it — in a perfect world, individuals would sit down early in their working careers with an advisor or online tool, estimate how much they might need to live on in retirement, figure out how much they needed to be saving now to attain that objective, and start saving at that rate. Of course, we don't live in a perfect world. But the more we — meaning advisors, plan sponsors and participants — are willing to begin with the end in mind, the better for all of us.

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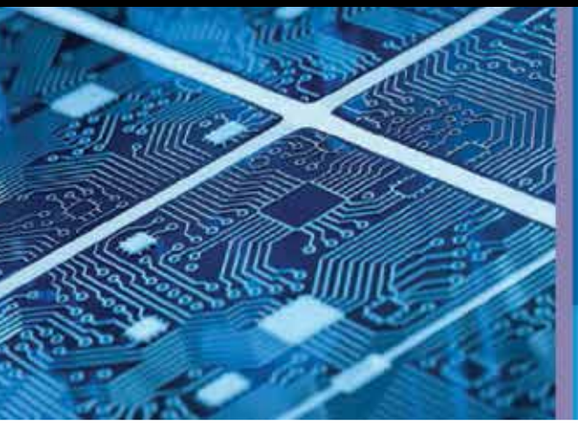

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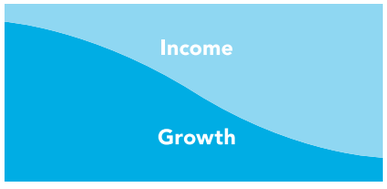
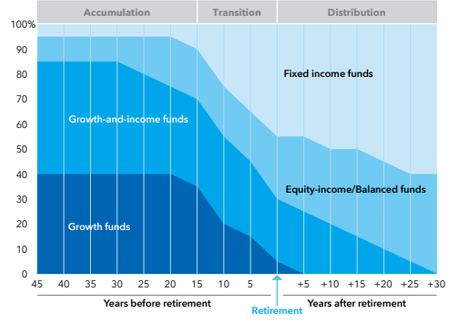


Traditional equity sleeve static equity allocation

American Funds Target Date Retirement Series Glide Path



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[1] Relative to their Morningstar indexes since the Series launched in 2007; as of December 31, 2014. [2] Based on Class R-6 share results for rolling periods through December 31, 2014. Periods covered are the shorter of the fund's lifetime or since the comparable Lipper index inception date. [3] Based on the net expense ratios for the American Funds Target Date Retirement Series funds (Class R-3) as compared to the most recent prospectus average expense ratios for the Morningstar Retirement, Medium fee level group, which is composed of target date funds classified by Morningstar as Retirement share class type with a 12b-1 fee greater than 0% and less than or equal to .50% as of December 31, 2014.

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THE OUTCOMES ISSUE

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01

THE **OUTCOMES** ISSUE

RISKS AND REWARDS:

Building a Better Investment Menu

t doesn't seem like an exaggeration to say that more time, effort and energy has gone into designing, developing and communicating the investment menu over time than any other plan feature — perhaps even all other plan features combined.

The advent of target-date funds and their subsequent enshrinement as a key qualified default investment alternative (QDIA) category has altered the landscape somewhat in recent years. However, those options, like the automatic enrollment designs that depend on QDIAs, are still more commonly found among the newly hired. For many employees on the brink of retirement, their outcomes will be shaped, as they have long been, by the investment choices provided on the investment menu, the education that supports a properly diversified portfolio and the discipline to maintain it.

Plan advisors who are seeking to help plan sponsors and participants navigate those menus know that the traditional stock/bond allocations will only get you so far. Longer lifespans can put strains on those resources and require a reassessment of not only the mix, but the timeframe(s) over which those shifts should be made.

In the pages that follow, you'll find three distinct perspectives on the impact that menu construction has on outcomes:

- how a core strategy based on active management can help with risk management (page 8);
- how to find the right mix of active and passive strategies (page 12); and
- how alternative asset classes can help DC plan performance, akin to the role they have played with traditional defined benefit pension plans (page 14).

Activate Your Core

What's at the core of your investment menu can make or break retirement outcomes.

BY RYAN MULLEN

Fitness experts say that a strong core supports your whole body and a weak one can put you at risk for physical problems. The same holds true for a defined contribution plan's investment lineup — and a participant's investment portfolio. What's at the core can make or break retirement outcomes.

Active investment strategies are essential to a strong core and a necessity in today's challenging markets, which are more complex, volatile and short-term-focused than ever. To navigate conditions like these, your defined contribution clients need skilled active management that selects securities thoughtfully, chooses risks intentionally and focuses on long-term value rather than short-term market swings.

The Cost of Surprises

Following recent fee disclosure regulations, there has been a great deal of focus on the costs associated with retirement plans, and the response has been a noticeable shift to passive investments. While fees need to be transparent, properly disclosed and reasonable, it's important to look at costs holistically. A passive-only core may lower explicit fees, but it may subject participants to potential damage, creating significant and unexpected costs during market downturns.

That's because while an entirely passive core — whether at the plan lineup or participant portfolio level — may hold up well in continuously rising, efficient markets, it can actually weaken a participant's outcome as volatility grows. Passive strategies take full market risk and thus follow the market's short-term trends, upward or downward. Lacking active risk management, a passive-only core subjects participants to the potential damage that increasing market volatility can do to their returns.

That danger is very real. Left unmanaged, volatility hinders the benefits of compounding and diminishes the rate at which investments can grow over time. For example, let's say a participant has a $100,000 portfolio that drops 15% in value one month and rebounds 15% the next. While the average return is zero, the portfolio still loses value. That's because while the 15% drop would have reduced the portfolio to $85,000, the 15% rebound would bring that $85,000 back to only $97,750. The $2,250 loss incurred is called "volatility drag," and, over time, it can do irreparable damage to retirement outcomes.

> "In a participant portfolio or plan lineup, a core made stronger through active risk management attempts to minimize losses in a market downturn."

There is similar concern in a severe market downturn. A passive core has no means of protecting capital, and as we saw in the global financial crisis of 2008, losses sustained in bear markets can be especially troublesome for investors nearing retirement. Yet passive investors don't seem to understand the true meaning of taking full market risk. In a survey conducted by MFS, nearly two-thirds of investors thought their stock index funds were safer than the market.[1]

A Strong Core Carries More Weight

Skilled active management can strengthen the core of a plan lineup and a participant portfolio, working alongside passive or on its own. That's because it has the research capabilities and active security selection to add value when the indices are inefficient, and uses active risk management to navigate volatility and changing market cycles effectively. "Activating the core" can broaden investment opportunities for your defined contribution clients while seeking to minimize losses along the way.

Turning Market Challenges into Opportunities

As the capital markets become more interrelated and companies operate more globally, the best investment opportunities could be anywhere in the world. To find them for defined contribution clients, active managers can immerse their analysts in local markets worldwide and use integrated research capabilities to evaluate an enormous amount of global information and develop the best of their investment ideas.

Active managers can also look past the markets' growing short-term focus, which runs counter to defined contribution plan participants' long-term objectives. By focusing on solid fundamentals, active managers pursue long-term value and sustainable returns, rather than trying to invest on short-term price swings driven by news flow and analyst earnings estimates. They can also use market "short-termism" as an opportunity. While the prices of securities tend to move in concert over short time frames, over longer periods, active managers can find a broader range of returns ("dispersion") and distinguish between the best and worst companies. Active managers who are patient enough to hold securities for three to five years or more can potentially provide the type of long-term value that participants need to improve their retirement outcomes.

Building Strength Through Active Risk Management

In a human body, a strong core protects against injuries. In a participant portfolio or plan lineup, a core made stronger through active risk management attempts to minimize losses in a market downturn. Unlike passive management, which takes full market risk, active management can budget risk thoughtfully and try to avoid the highest-risk companies and segments of the market. That's especially important during "bubbles" — technology in the 1990s and financials in 2008 — when having full market exposure can be devastating to a retirement portfolio. For defined contribution investors, the ability

1 Defined Contribution Investments, 2014 MFS DC Pulse Survey: The Retirement Equation.

to minimize losses in market downturns is just as important as, if not more so than, pursuing gains in strong markets.

The chart below illustrates how active management supports a portfolio through changing market conditions. Specifically, we looked at the S&P 500 over the past 25 years and compared the performance of what we define as skilled active managers (top 25%) and average active managers (top 50%) when markets both rose and fell in a given year. We found that while active managers in general added value in down markets, skilled active managers added value in both types of markets.

A strong core uses different muscle groups to help protect the rest of the body. For your defined contribution clients — at the portfolio or plan level — a strong core can be built in different ways using a variety of investment strategies. Because that core is the foundation that must support a successful retirement outcome, however, it's important to keep at least part of it highly skilled and very active.

» Ryan Mullen is MFS' Senior Managing Director and Head of Defined Contribution Investments.

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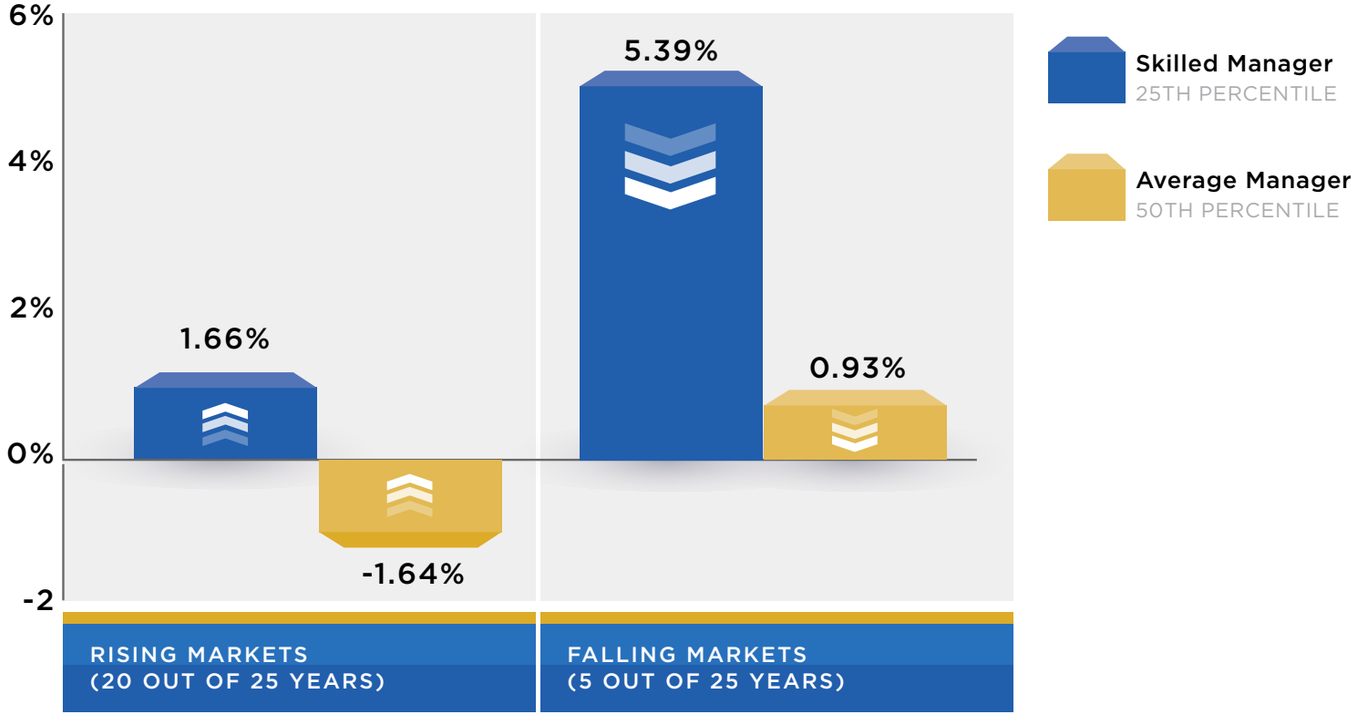
ACTIVE MANAGERS ADDED VALUE IN CHANGING MARKETS
Excess returns of US large cap blend active managers from 1990-2014



Source: MFS, Factset. Calculated based one year returns based on when market rose or fell 1990-2014.
Skilled and average managers returns calculated based on the 25th and 50th percentiles respectively for the Morningstar US.
MFS defines skilled active managers as those who perform in the top 25th percentile.

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Indexing Versus Active Management

Providing efficient portfolio building blocks for participants.

BY CHIP CASTILE

Increased focus on fees, investment expenses and transparency is fueling a growing trend toward index strategies in DC plans. Of course, indexing is not new in DC; it has long had a significant role in mega and large institutional DC plans. But now, the industry is seeing indexing gain interest and momentum in the small- and mid-sized plan markets as well.

Putting aside the specific factors that might drive the choice for an individual plan, the choice between indexing and active management by plan sponsors is driven in part by practicality and part by investment philosophy. On the practicality side, index management is generally going to be less expensive than an equivalent actively managed exposure. As for investment philosophy, if your goal is to capture market returns as closely as possible, then indexing may be the right choice. If, however, you believe that a good investment manager can capture above market returns — the ever-elusive alpha — then that can only be done through active management, often through stock selection or by having the flexibility to go to cash when the manager sees a lot of uncompensated risk in the market.

It is usually an either/or choice — plans either use index funds or they use active managers.

However, this is not generally an either/or choice by the plan sponsor. From the plan design point of view, the first-tier choice should be a qualified default investment alternative, such as a target date fund or an allocation fund that may use indices or active managers.

The second tier may be comprised of the building blocks of a diversified portfolio. A suite of efficient, professionally managed index funds based on a range of recognized indexes provides the ideal building blocks and allow investment managers or individual participants to execute allocation strategies with minimal concern for tracking error.

The third tier may be comprised of more specialized exposures, including both index and actively managed funds, for more investment-savvy participants.

We're seeing a trend toward indexing in the small- and mid-plan space, particularly with respect to mutual funds. This is partly in response to the recent regulatory focus on fees and the desire for increased transparency. Plan sponsors like the fact that mutual funds have publicly available prices and detailed, standardized disclosures for prospectuses and order communication. Of course, we have seen the trend toward indexing for some time in the Collective Trust Funds (CTF) space, which generally serves mega and large plans.

> "The choice between indexing and active management by plan sponsors is driven in part by practicality and part by investment philosophy."

Industry wide, it's expected that assets in index products will have doubled from 2005 to 2015. This makes sense when you recognize that this would bring it closer in alignment with the percentage of indexing we see in defined benefit plans.

Index-based target date funds are an attractive option for many of the same reasons. But you need to frame up the conversation about index and active management in target date funds differently. You need to talk about how that difference in investment philosophy influences the glidepath as a target date fund matures. The glidepath is designed to achieve an expected terminal value, but there is a distribution of expected outcomes around that terminal value. This is regardless of the investment horizon, although the longer dated a target date fund is, the wider the distribution is likely to be.

The question is: can you get the distribution that you want through the use of index or actively managed funds? We think you can with either.

As for how the active/passive choice influences the range of expected participant outcomes, let's assume we're building a target date fund with a maturity 15 years out. As you follow out your expected risk and returns across 15 years, the range of outcomes broadens as you approach maturity. It's really the glidepath, which captures 15 years of strategic asset allocation adjustments, that is shaping this distribution of outcomes. The difference in range of outcomes between active and index management is marginal in comparison. Marginal, but still important.

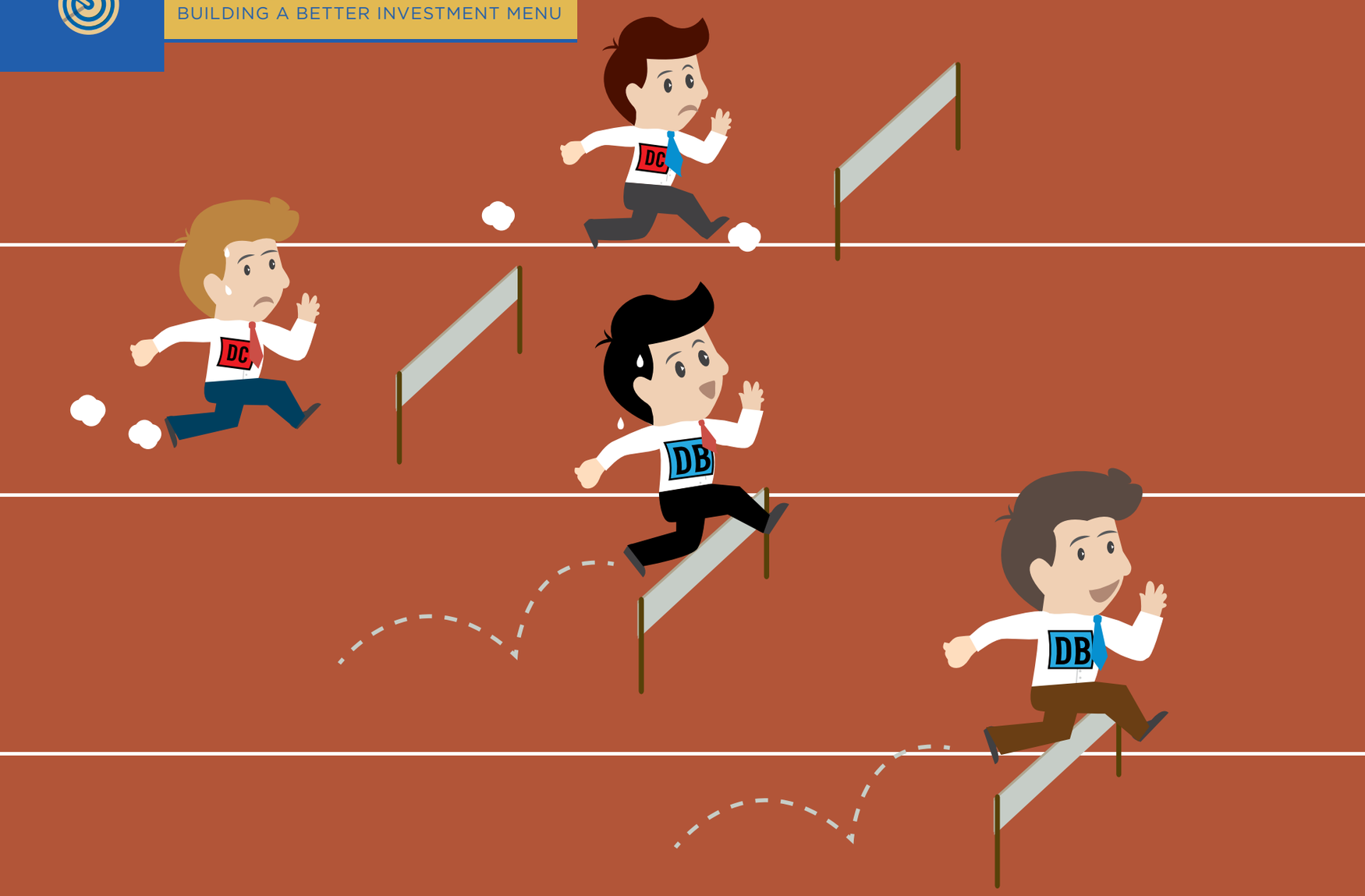
Indexing will provide a slightly more narrow range of outcomes. Lower fees are part of that tighter distribution. The distribution of outcomes from active management will spread a little higher in the range, offering more return if it is successful and a little lower because it has more risk in it. Successful active management can get you higher consumption for the same level of savings.

Active management also offers the potential to shape distributions, ideally by cutting off the lower range of expectations and reshaping the range of outcomes to skew more positively. This can be done on the manager level, if the individual manager has a flexible enough mandate, or at the asset class level by reoptimizing a multi-manager allocation to manage risk. On the other hand, the stronger your belief in the glidepath and the consensus strategic assumptions built into it, the more attractive a pure index approach may be. You give up the potential to shape distributions, but gain greater certainty that you will accurately capture the market.

Of course, you can do both within a glidepath and we think it's a potentially attractive way to go. It gives you the choice of how to spend your risk capital and where to seek your alpha opportunities. Within the large cap asset class, for example, you can take on active risk by selecting managers within certain style boxes, such as growth, value and so on, add index exposure, and reoptimize the portfolio to potentially achieve greater returns for the same level of risk.

Ultimately, it's a matter of understanding the differences. Index funds give you a tighter distribution of outcomes. If that's important to you, then that is the approach to take. But that means giving up any opportunity that active managers have to reshape the distribution of outcomes in a favorable way by taking less risk when they don't expect to get paid. That is a perfectly reasonable trade-off to make. The key is understanding what you're doing and being really explicit about what you want the outcomes to look like. Both can be incorporated into a plan's design in a thoughtful way.

» Chip Castille is the head of BlackRock's U.S. and Canada DC group.



‘Hedging’ Your Bets

Expanding the DC menu beyond traditional asset classes.

BY DAVID KUPPERMAN AND SCOTT KILGALLEN

Defined contribution plans are rapidly becoming the primary retirement saving vehicle for most U.S. employees. Currently, 69% of private sector workers have access to DC plans but only 7% have access to defined benefit (DB) plans.[1] Yet, DC plans have not kept pace with DB plans when it comes to investing in alternative investment strategies such as hedge funds, private equity and infrastructure. Such allocations have played an important role in improving the risk/return characteristics of DB portfolios and have contributed to their outperformance of DC plans.

While some of the disparity between DB and DC performance may be attributed to factors such as fees, poor portfolio construction and market timing by participants, we believe the lack of alternative investments is an important factor in DC plan underperformance. And although lack of data makes it difficult to do a proper attribution, studies show that most DC assets are allocated to traditional stocks and bonds, limiting participants' ability to access the potential improved risk/return profile and portfolio diversification from alternatives that their DB counterparts capture.

FIGURE 1

THE ADDITION OF ALTERNATIVES HAS HISTORICALLY BOOSTED DB PLAN PERFORMANCE

Asset Mix and Returns of DB Plans Compared to DC Plans 1997-2013

	ALLOCATION (%)		RETURN (%)	
ASSET CLASS	DB	DC	DB	DC
TRADITIONAL				
Large-Cap Stock	29%	33%	5.8%	6.4%
Small-Cap Stock	6%	8%	7.7%	8.2%
Foreign Stock	23%	7%	5.7%	7%
Employer Stock	0%	18%	n/a	7.9%
Fixed Income	31%	11%	7.4%	6.1%
Stable Value/GICS	0%	19%	n/a	4.6%
Cash	2%	3%	3.5%	3.1%
ALTERNATIVES				
Real Estate, REITS & Other Real Assets	4%	0%	9.5%	0%
Hedge Funds	2%	0%	7.1%	0%
Private Equity	4%	0%	9.5%	0%
TOTAL 100%		0%	7.20%	5.80%

Source: CEM Benchmarking. Asset mix equals the simple average of annual asset mix weights. Returns are the compound average of annual averages for each asset class. Hedge funds were not treated as a separate asset class until 2000, so 60% stock / 40% bond returns were used as a proxy for the period 1997-1999. Based on data observations of 2,465 DB plans and 1,684 DC plans.

Potential Benefits of Liquid Alternatives

Today's increasingly volatile and ever-changing market conditions have led some DC plan sponsors to question if the traditional equity and fixed income investment options in their plan are adequately fulfilling their participants' needs. This issue is particularly important when it comes to fixed income. Investors have lived through a nearly 30-year bull market in fixed income and many DC plan participants have come to rely on a heavy allocation to fixed income as they approach retirement. This has spurred interest in liquid alternatives, as DC plan sponsors look for solutions that might help participants in a rising rate environment. Historically, fixed income has performed poorly during periods of rising interest rates, while certain hedge funds strategies have actually benefited from those dynamics.

Against this backdrop, we are beginning to see more plan sponsors looking to broaden their platforms to include alternative investments. Traditionally, alternative investments such as hedge funds were not seen as appropriate for DC plans due to high fees, a lack of transparency, limited liquidity and limits on investor qualification. These issues have now been addressed by liquid alternatives offered through mutual funds registered under the Investment Company Act of 1940 ('40 Act) that employ single or multiple hedge fund strategies.

At the same time, hedge fund managers have recognized the growth of DC plans and, as a result, more quality funds and solutions are available. In prior years, hedge fund managers were reluctant to deliver their strategies at the lower costs required by DC plans. Now, with the potential size of the opportunity in DC plans, that mindset has changed.

Indeed, the introduction of alternative strategies in publically offered mutual funds has created an opportunity for DC plans to add hedge fund strategies to their platforms.

Fig. 1 demonstrates how a liquid alts fund can meld the benefits of traditional hedge funds with those of a mutual fund in a DC plan-friendly format.

Bridging Hedge Fund and Mutual Fund Benefits

Expanding investment options to a broader universe of strategies, like those in the realm of alternative strategies, can provide participants:

- another solution in pursuit of incremental return and risk management;
- the potential to more effectively manage volatility;
- an opportunity to achieve greater diversification through the addition of a strategy less sensitive to the broader equity and fixed income markets.

Adding Alternatives to the Menu

In our view, DC plan sponsors have two key decisions to make with regard to incorporating liquid alternatives into their offerings. The first is whether to make such choices part of the plan's core investment menu, allowing participants to select how to allocate to them in a portfolio, or alternatively, to offer them in target date or custom balanced funds where the allocation is professionally managed.

The target date approach can be an effective way to incorporate liquid alternatives in a DC plan. Target date funds can allow participants to automatically gain exposure to the previously discussed benefits associated with liquid alternatives. However, not all target date funds include

1 Source: U.S. Department of Labor, Form 5500 Summary Reports through 1998; EBRI Databook 1999-2011.

	TRADITIONAL MUTUAL FUND INVESTING	TRADITIONAL MUTUAL FUND INVESTING
Return Objective	Relative returns	Absolute returns
Benchmark	Benchmark constrained	Unconstrained by benchmark index
Investment Strategies	Limited strategies, long-only, no leverage	Flexible strategies (long and short positions, leverage)
Market Beta	High beta to traditional asset classes	Generally low beta to traditional asset classes
Performance	Dependent on market direction	Often independent of market direction
Management Fees	Asset-based fee only; no performance fees	Generally higher asset-based fee than mutual funds; Performance fees
Liquidity	Daily at NAV	Liquidity restrictions and lock-ups
Investment Size	Minimums as low as $1,000	Large minimums
Investor base	Publicly available	Qualified purchasers
Transparency	High disclosure and transparency	Limited or no position level transparency

Source: Neuberger Berman

BRIDGING BENEFITS

an allocation to liquid alternatives. In general, the target date funds offered in DC plans employ strategies focused on traditional long-only style-box based investments, with minimal, if any, alternative investment exposure. Nonetheless, allocations to liquid alternatives in custom target date funds and some off-the-shelf target date funds are now happening.[2]

Adding liquid alts to a plan's core menu, in our view, is another viable approach to including liquid alts in a DC plan platform. A good portion of participants still use their plan's core menu to build their own portfolio. However, the average DC plan menu of equity funds, complemented by a few money market and core bond funds, may not provide enough options for participants to diversify effectively.[3] This menu design works well for participants accumulating assets, but today the majority of assets in many plans are held by participants nearing retirement. As a result, providing them with investment options that protect from drawdowns and volatility is becoming critically important. The addition of a liquid alternatives option can help participants implement a more robust allocation with diversification across volatility management, growth and income options.

> DC plans have not kept pace with DB plans when it comes to investing in alternative investment strategies such as hedge funds, private equity and infrastructure."

Participant Education Critical

The general lack of sophistication among participants when it comes to these types of strategies makes participant education critical. Participants will need guidance on how liquid alts might be used as part of broader overall asset allocation based on their specific objectives. We believe it can be helpful to position the DC plan investment menu so that participants think about options in terms of the roles they play in an asset allocation — for example, classifying options as designed for growth, income, volatility management or outpacing inflation.

As DC sponsors look for ways to improve their DC participants' risk/return profile and help them reach better retirement outcomes, look for an increased conviction to add diversifying alternative asset classes to the plan menu. Every plan is different, so there is no single approach to adding liquid alternatives that makes sense for all. But DB plans have demonstrated that including alternative strategies in a portfolio can enhance its risk/return characteristics. We believe this is likely to continue, especially in light of current valuations in the traditional investment marketplace and the potential for rising interest rates.

Additionally, alternatives, once considered inaccessible for DC plans, are now readily available through liquid alternative mutual funds. DC plan sponsors looking to replicate the DB plan experience for their DC participants may want to consider adding liquid alternatives to their DC plan menu.

» David Kupperman is Co-Head of Neuberger Berman, Alternative Investment Management.

» Scott Kilgallen is Head of Financial Institutions Group at Neuberger Berman.

2 Source: Liquid Alts in Target Date Funds, Infovest 21, 2014, Issue 4 and BrightScope.

3 PSCA's 57th Annual Survey of Profit Sharing and 401(k) Plans, 2014.

02

THE OUTCOMES ISSUE

OUTCOMES ORIENTED

Plan Designs

Plan design has traditionally been a function of incorporating features that are competitive or comparable as a workplace benefit, in much the same way as vacation time, sick leave or health coverage are determined. This might entail using benchmarks such as comparisons with local businesses, specific industry offerings or national surveys. Regardless, plan design has generally been focused on the here-and-now — that is, what the plan sponsor can afford and what would match up favorably with other organizations vying for the same talent pool.

Those concerns remain front-and-center in today's plan designs. But the passage of the Pension Protection Act of 2006 (PPA), and its emphasis on automatic plan features, has arguably created a "new normal" in which most new hires, and many existing workers, are enrolled in the plan without having to complete an enrollment form or make investment choices. These days they may not even attend an enrollment meeting.

Nearly a decade after the passage of the PPA, those automatic designs, which have done so much good in helping workers save and prepare for retirement, are wearing a little thin. Tomorrow's outcomes-based plan will want — and need — to do more, not only to be competitive, but to help today's workforce be adequately prepared to meet the challenges of retirement.

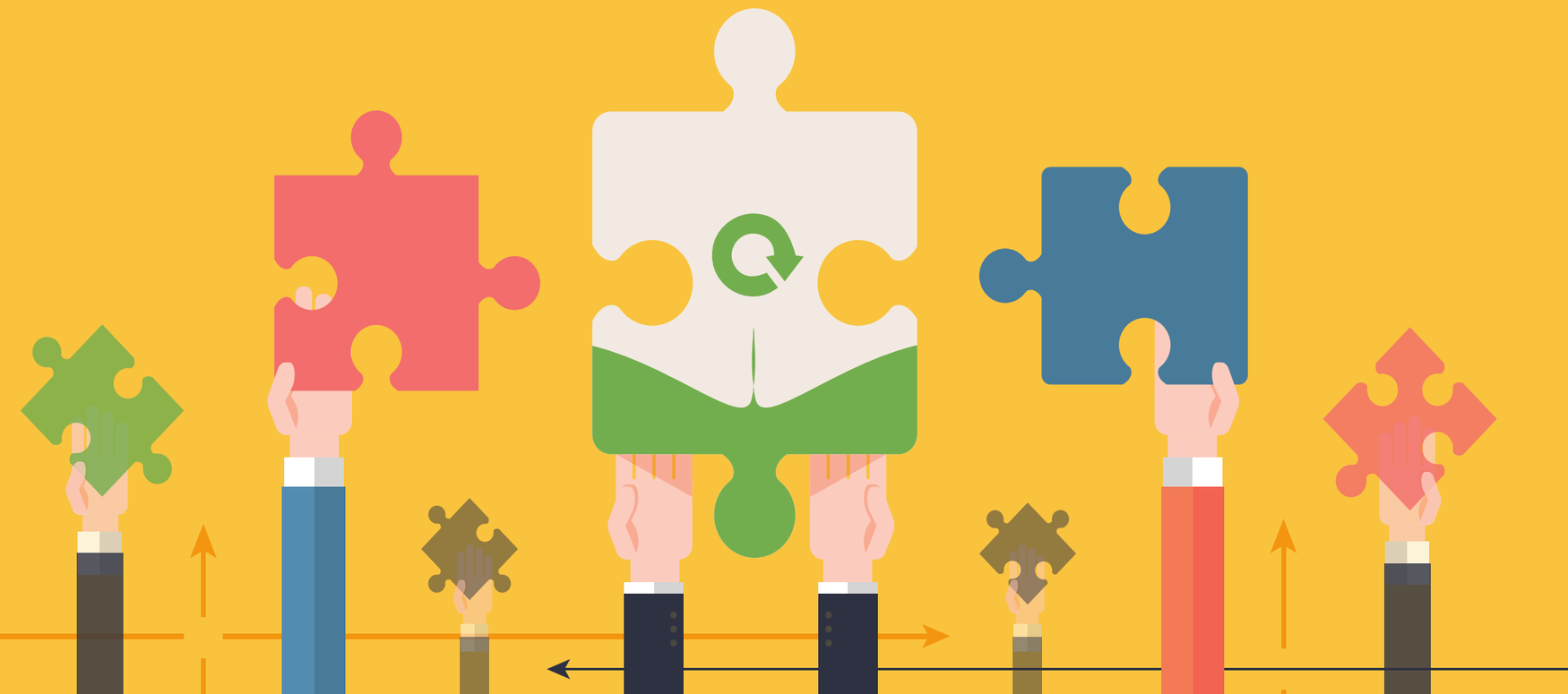
In this section, you'll gain perspectives on:

Re-Enrollment Can Lead to Better Participant Outcomes

Improve diversification through re-enrollment.



BY TONI BROWN, CFA, JOHN DOYLE AND MARK STEBURG



The investment options a plan offers — especially its default option — have the potential to significantly influence how participants allocate their assets. By offering a qualified default investment alternative (QDIA) such as a target date fund (TDF), sponsors can help ensure that their participants are appropriately diversified.

TDFs represent a current best practice for new plan design. While new enrollees tend to choose QDIAs, such as TDFs, or end up being defaulted into them, many existing participants remain invested in a portfolio of individual funds that were available when they initially enrolled. Their accounts may not be suitably allocated given their current goals or the options available to them, a situation that may reflect participant inertia, a lack of investment understanding or simply indecision.

To address these issues, leading plan fiduciaries have pursued re-enrollment, a process that is much more straightforward than many realize. The plan sponsor announces that, as of a specific date, current balances and future contributions to the plan will be automatically invested in the plan's QDIA unless participants opt out by re-selecting their current investments. Participants can then revisit their plan selections to correct imbalances or take advantage of investments that were not available when they originally enrolled. In effect, the re-enrollment is more of a reallocation that can help improve the participant's long-term retirement outcome.

The case studies on the following page describe the experiences of two companies that have pursued re-enrollment with a high degree of success. (The experience of others may differ.)

Weigh Participant and Fiduciary Concerns Against Plan Objectives

While some sponsors may wonder how participants will respond to a re-enrollment, in our experience, they tend to appreciate the help.

- TDFs are a convenient option. Many participants prefer TDFs because of the built-in diversification and automatic rebalancing they provide.
- Participants can still make changes. Participants retain the ability to change their investment selections in the future.
- Fiduciary protection may be expanded. Default investments in QDIAs are covered by an ERISA safe harbor.
- There is no wrong time. Because markets rise and fall without warning, plan fiduciaries are not expected to try to time a re-enrollment based on market events.

"While some sponsors may wonder how participants will respond to a re-enrollment, in our experience, they tend to appreciate the help."

Tips for a Successful Re-Enrollment

1. Announce early and repeat often. Announce the event 60 to 90 days in advance and explain the benefits with on-site meetings.
2. Manage the contact list. Verify current addresses, especially for former employees and beneficiaries. Have a process in place to track undeliverable mail.
3. Go beyond emails and signs. Use newsletters, texts and even a confirming telephone call as the re-enrollment period nears its end.
4. Tell participants they have choices. Selections can and should be revisited regularly, and participants should consider their non-plan assets as well.
5. Consider making other plan changes at the same time. Take the opportunity to implement other plan improvements, such as updating the investment menu, while you have participants' attention.

Re-enrollment in Action

The charts on page 21 demonstrate how re-enrollment can help participants to become better allocated. In this example, participant allocations vary greatly before re-enrollment. During re-enrollment, however, most participants elected or defaulted into the QDIA.

Conclusion

Sponsors are committed to looking out for the best interests of participants. Conducting plan re-enrollments is an expression of that commitment, as they can help participants positively improve their financial security in retirement.

» Toni Brown, CFA is a Senior Defined Contribution Specialist at American Funds.

» John Doyle is a Senior Defined Contribution Specialist at American Funds.

» Mark Steburg is the Senior Vice President, Retirement Plan Products at American Funds.

For more information on how American Funds can help you plan a successful re-enrollment, contact your American Funds representative or call us at (800) 421-9900.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

The statements above are the opinions and beliefs of the speakers expressed when the commentary was made and are not intended to represent their opinions and beliefs at any other time.

CASE STUDY 1: AN ACCOUNTING FIRM BASED IN CONNECTICUT

Re-enrollment date	Participants	Total plan assets	Avg. Account balance
January 1, 2014	20	$3 million	$150,000

Prior participant investments	QDIA rolled into	After re-enrollment
Balanced fund as QDIA, along with other funds	TDFs	79% in QDIA

Successes and challenges faced

"We explained that TDFs may be a better QDIA than a balanced fund because they are age-appropriate investments that suit each employee's investment timeframe."
— Advisor with large wirehouse firm

"TDFs strip out a lot of the emotion, allowing people to feel comfortable that their investments are being professionally managed with retirement and life goals in mind."
— Principal of the accounting firm

CASE STUDY 2: UTILITY COMPANY BASED IN THE WEST

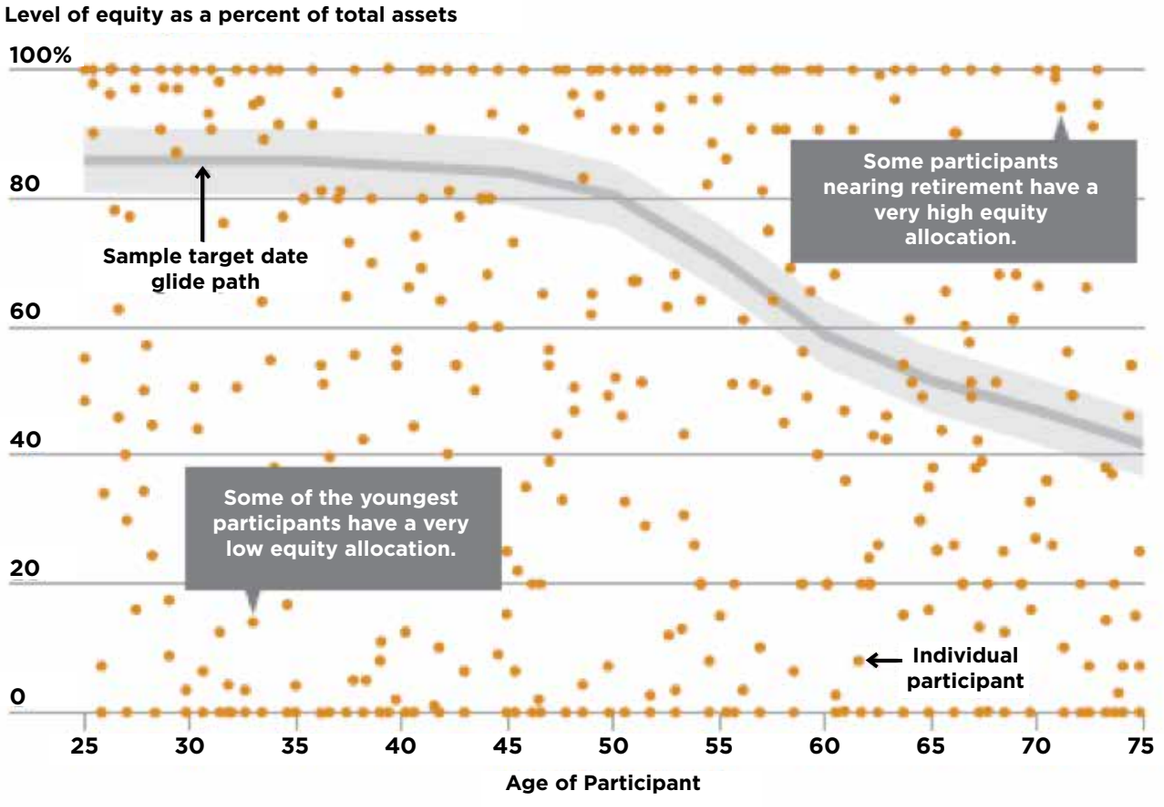
Re-enrollment date	Participants	Total plan assets	Avg. Account balance
January 1, 2014	7,500	$1.2 billion	$150,000

Prior participant investments	QDIA rolled into	After re-enrollment
15 core fund	Custom TDF	60% in QDIA

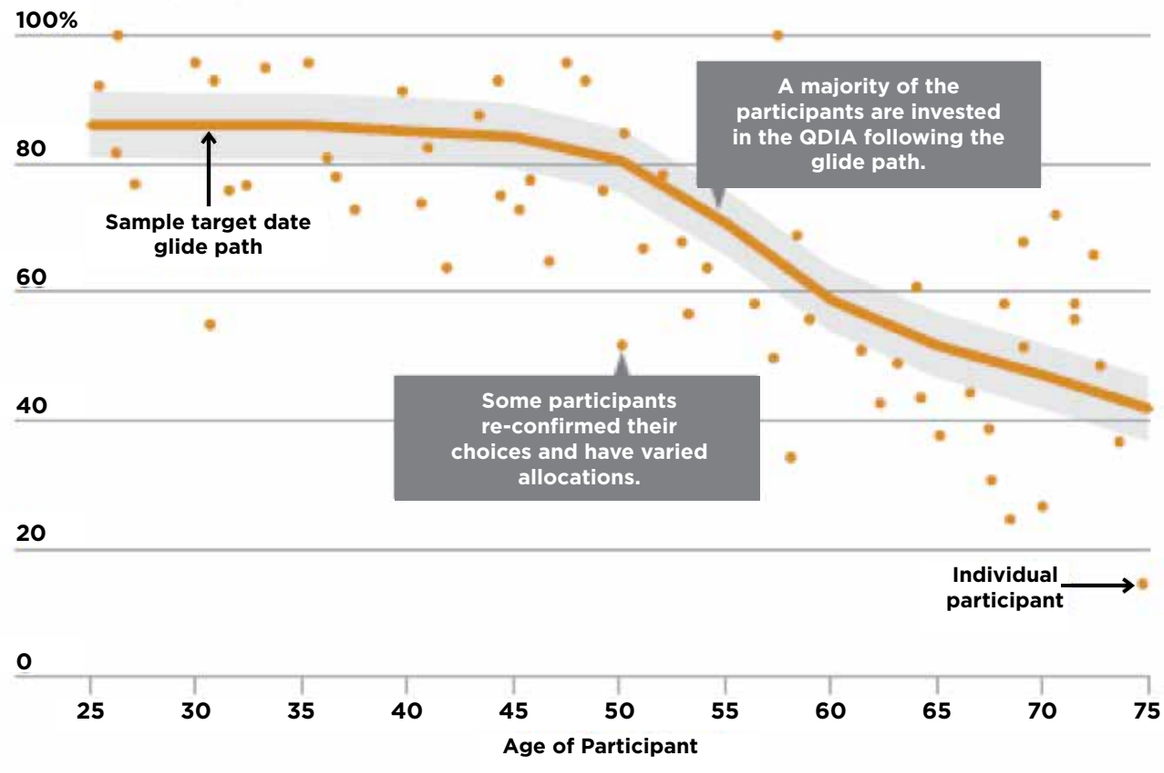
Successes and challenges faced

"There was a good deal of upfront work from both the plan sponsor and administrative team, so it's important to have the right resources in place in advance. But the investment is absolutely worth it. I believe very strongly that re-enrollment is the right thing for participants, and I would encourage plans that are considering it. From a plan sponsor's perspective, it's a good work-force management practice. In the end, you'll have participants who are better prepared to retire."
— Consultant with large global consulting firm

BEFORE RE-ENROLLMENT



AFTER RE-ENROLLMENT



Getting off to a Good Start

Successful participant outcomes begins with progressive plan design that maximizes positive participant behaviors.

BY RICHARD W. RAUSSER

As with most things in life, there is nothing more important than knowledge. And when it comes to influencing participant behavior regarding their retirement, that knowledge comes in the form of personal education. This is not to say that every plan participant needs to become an expert on the ins and outs of retirement planning. However, with a relatively simple approach taken by employers, participants should be able to understand their options in a relatively simple and coherent manner.

The need for education is underscored by a survey we conducted with Harris Interactive, which revealed that while 75% of U.S. employees currently enrolled in a 401(k) think that such plans are the most important source of one's retirement income, 65% do not believe, or are not sure, that their 401(k) plan will provide enough money for them to be able to retire when they want/plan to.

But the retirement planning industry has learned that education alone does not drive participant behavior; real plan effectiveness needs to be measured in terms of whether participants are on track to succeed. Therefore, ensuring successful participant outcomes begins with progressive plan design that maximizes positive participant behaviors.

Plans with automatic features that better meet the needs of plan participants and plan sponsors help drive successful outcomes by helping participants hit the all-important 10% savings rate that we believe is crucial. Participants benefit as they experience higher levels of retirement success and retirement readiness; plan sponsors benefit as participants become more engaged with their plan and are better prepared for the long term prospect of saving for retirement. Improved defined contribution plan outcomes also serve to ease the loss of the traditional defined benefit pension plan, which may have been closed, frozen or cut back.

Automatic 401(k) plan features include automatic enrollment, automatic escalation of salary deferrals, auto rebalancing and utilization of qualified default investment vehicles. These features help plan participants set a reasonable level of salary savings, increase their contributions over time, achieve proper investment diversification, and make better use of a plan's investment alternatives. Placing participants in an appropriate investment option at a preselected contribution rate that increases annually essentially replaces some of the most important features of a defined benefit plan, such as automatic coverage and professional investment management.

"Ensuring successful participant outcomes begins with progressive plan design that maximizes positive participant behaviors."

Strong participation rates start with eligibility features that make it easy for participants to take advantage of a 401(k) plan from the start. Getting employees enrolled in the plan right away, and giving them an "ownership" stake in their investments, makes it easy to start payroll deductions and get employees into the habit of saving through the plan. Allowing new hires to make rollover contributions to the plan and providing them with an easy way to keep from spending lump sum distributions from a prior plan is also advisable.

Online enrollment is a more efficient interface operationally, and provides administrative ease. It can also be used as a mechanism that will make participants more likely to use online financial planning and guidance tools to map out a strategy from day one. Today, 47% of employers have a 401(k) plan auto-enrollment feature that is coordinated with online enrollment.

The primary advantage of auto-enrollment has been to get at least 90% of workers into a retirement savings plan. Research shows that automated solutions positively impact participant behavior and savings rates.

Auto-enrollment can be improved upon. Typically, automatic enrollment sets participants' initial contributions at a minimum of 3% of their pay, increasing their contributions by 1% a year (up to 6%). While the 3% deferral rate is good, a 6% deferral rate is an even better starting point and what we recommend as a best practice. Using 6% of pay for automatic enrollment goes a long way toward increasing savings rates overall — in particular, if one's matching contribution is tied to a higher deferral rate. Doing so also enables senior executives and highly paid employees to save more by improving 401(k) nondiscrimination test performance.

While some may question whether automatic enrollment is worth the cost of additional employer matching contributions, the rise in cost will often be modest; most higher paid employees sign up for a 401(k) plan on their own. But employers are increasingly finding that the benefits outweigh the incremental additional cost. Automatic enrollment can make employees feel more secure, thereby improving morale and a company's ability to attract and retain talent.

Encouraging participants to save more by using an auto-escalation feature is another integral best practice. Auto-escalation of at least 1% per year, but preferably 2%, is ideal. By adding such a feature to the initial auto-enrollment at 6% of pay, many employees will hit the all-important 10% of pay savings rate that we believe is crucial within a few years.

A word of caution: Do not rely upon automatic features in perpetuity. Periodic re-enrollment and employee education meetings help participants map out a strategy and stick to that strategy to attain their long-term goals. Re-enrollment of existing plan participants helps participants take a fresh look at how they are investing their contributions, and may include new or updated tools to help them make their decisions.

An educated plan participant is always a plus ... but that's not the only and/or final requirement for a successful retirement outcome. By employing automatic features and staging periodic re-enrollment and education meetings, you will be doing your plan participants — and yourselves — a great service.

» Richard W. Rausser, CPC, QPA, QKA, is a Senior Vice President at Pentegra.

A ‘Means’ to an End

Retirement plans as a health care cost solution.

BY TOM MCKENNA AND
CHRISTOPHER LEONE

According to a number of industry studies, health care costs are among the leading financial concerns of pre-retirees. Their unease is valid, as current data suggests that medical expenses will be one of the most significant costs in retirement. Aside from the projected growth of health care inflation to 6% and the fact that Medicare only covers approximately 50% of retirement medical costs, another variable will place significant stress on retiree budgets: Medicare means testing.

MAGI and Means Testing

To understand Means Testing, one needs to have a cursory understanding of Modified Adjusted Growth Income (MAGI). We are taught early on in our financial services careers to tactfully refer clients to accountants when complicated tax questions arise, but MAGI isn't as difficult a concept to master as it sounds. The number includes almost every source of income — including Social Security, required minimum distributions (RMDs), capital gains, and even tax-exempt interest from municipal bonds — earned in a household. It is used as a means-testing gauge to ascertain a household's ability to pay Medicare premiums. However, one income source that does *not* increase MAGI is *revenue generated from a Roth 401(k).*

In 2003, The Medicare Modernization Act sought to transfer some of the unwieldy costs of government spending back to more affluent subscribers by tacking on additional surcharges for Medicare parts B (doctor visits and tests) and D (prescription drugs) based on MAGI. This approach sought to leverage rising Medicare costs by charging more to those who could "afford" it. In fact, Medicare premiums can vary by more than 200% from person to person (for the same coverage) depending on their income bracket.

Unfortunately, these brackets are not currently indexed to inflation, which is why means testing will soon become a mainstream issue. HealthView has found that as household incomes rise — even with just basic cost of living adjustments (COLAs) — it is only a matter of time before more future Medicare recipients (and not necessarily affluent ones) find themselves subjected to higher premium thresholds. In fact, a 40-year-old male of today with an annual salary of $40,000 wishing to retire at 66 with an annual COLA of 3% could be earning more than $86,000 per year by the time he is done working, which would indeed put him into the second means testing tier. Furthermore, HealthView's reporting system has found that upwards of 40% of current financial services clients, ranging in age from their late 40s to mid 60s, are expected to incur Medicare surcharges based on their future expected income.

It is important to note that means testing continues to be a hotbed topic on Capitol Hill, as additional legislation was recently passed that will actually lower income thresholds in 2018. What does this mean for future retirees? Millions more will experience Medicare surcharges as their MAGI vaults them into higher means testing brackets. (See Figure 1.)

The Power of the Roth

The only option to avoid surcharges (without reducing necessary income) is to address MAGI. The paradox of trying to reduce this type of income is that the average retirement saver continues to build wealth in the very investment vehicles, such as traditional IRAs and 401(k)s, that increase MAGI. Nobody is suggesting that investing in these accounts is a bad way to accumulate wealth, but given the fact that less than 50% of 401(k) plans offer the Roth option, and there is less than a 10% adoption rate in the plans that do offer it, it might be a good time to broach plan-design discussions with sponsors and provide new education possibilities for participants.

The Roth option in a 401(k) (or 403(b)) can also minimize exposure to unwanted RMD's for those ages 70½ and older. HealthView has termed RMDs the "silent killer" of retirement income planning. Here's why: one extra dollar of income from the wrong source can bump retirees into higher MAGI thresholds and trigger thousands of dollars in extra surcharges, which will remain for years to come. The normal decision of choosing the Roth option versus the traditional option really only addressed the question: "Will the client likely be in a higher tax bracket now or later?" With means testing on the rise, it would be a mistake to exclude this important variable from the planning process.

Consider the case of Mike, a worker who began investing at age 35 into his 401(k).

FIGURE 1: CHANGES IN MEANS TESTING THRESHOLDS

INDIVIDUALS THROUGH 2017	INDIVIDUALS STARTING IN 2018	COUPLES THROUGH 2017	COUPLES STARTING IN 2018
<$85,000	No Change	$170,000	No Change
$85,001–$107,000	No Change	$170,001–$214,000	No Change
$107,001–$160,000	$107,001–$133,500	$214,001–$320,000	$214,001–$267,000
$160,001–$214,000	$133,501–$160,000	$320,001–$428,000	$267,001–$320,000
$214,000+	$160,000+	$428,000+	$320,000+

> Upwards of 40% of current financial services clients, ranging in age from their late 40s to mid 60s, are expected to incur Medicare surcharges based on their future expected income."

Mike is currently 55, has a desire to retire at age 65, and has determined, with the help of his advisor, that he will need $161,000 per year to live on in retirement. Mike is lucky that he will retire with both Social Security and a pension — two sources that provide steady income (unfortunately, they also increase his MAGI). He will also be able to withdraw an additional $83,000 per year from his defined contribution plan. As Figure 2 indicates, if Mike saves and withdraws from a traditional 401(k), that will push his MAGI over means testing thresholds and be subjected to an additional $226,545 in Medicare surcharges over the course of his retirement.

In both cases, Mike will receive the needed income of $161,000, but if he chose to withdraw from the Roth instead, he would only realize $78,000 in MAGI. In simple terms, if Mike had simply chosen a Roth 401(k), he could have saved over a quarter of a million dollars in Medicare premiums during his retirement.

The Early Intervention Advantage

The 401(k) industry is the ideal setting to open discussions with investors on health care costs because the major advantage that retirement plan advisors have over all others is *early intervention*. By being able to engage workers at a young age, 401(k)s provide the ideal forum to educate participants in how to fund this future liability.

Ironically, the 401(k) industry may even be a good place to educate folks on how not to fund health care. A 2014 MFS survey of institutional clientele found that over 12% of loans from retirement plans were taken out to cover health care costs — an unfortunate side effect of a possible crisis in the making.

Health care cost analysis is a new concept in the retirement plan world, but one that is coming of age. In an industry where so much time and energy is dedicated to making decisions on investment selections based on a few basis points of differential on an expense ratio, or a few dozen basis points on a 10-year performance number, it is hard to ignore the impact of what a 20,000 basis-point mistake might cost a client who ends up in the highest Medicare bracket rather than the lowest.

Means Testing Minimization

As an industry, we know that the exercise of selecting the proper strategy to increase monthly Social Security checks ("Social Security Optimization") is a vital piece of the retirement puzzle. However, we believe that a new concept — "Means Testing Minimization" — is just as important to ensure that surcharges don't consume all of that "extra" income.

Means testing minimization is just one approach that retirement plan markets can offer to help clients achieve financial security in relation to future medical expenses.

» Tom McKenna is the Director of Institutional Sales for HealthView Services. He oversees the company's efforts in assisting retirement plan sponsors, advisors and participants with health care cost planning strategies.

» Christopher Leone has been the senior researcher and writer for HealthView services since 2009. He has produced several white papers on topics associated with health care in retirement, and has taught courses at Wheelock College, Suffolk University and Boston University.

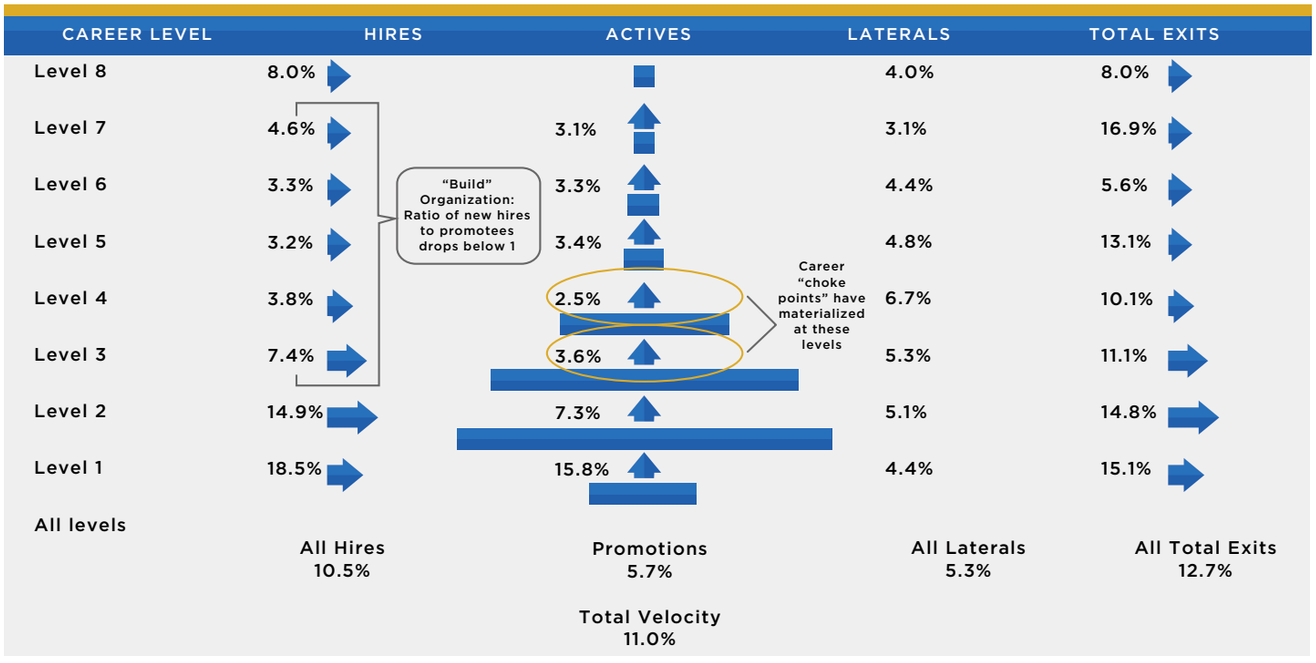
FIGURE 2: CASE STUDY

HEALTHY 35 YR. OLD MALE, RETIRES AT 65, LIVES UNTIL 86	ROTH 401K	TRADITIONAL 401K
Social Security	$25,000	$25,000
Pension	$53,000	$53,000
Annual Withdrawal from Retirement Plan	$83,000	$83,000
Total Income	$161,000	$161,000
Total Income (MAGI)	$78,000	$161,000
Income Band (Medicare Means Testing)	>$85K	$160K–214K
Healthcare costs throughout retirement	$270,713	$497,258

Source: HealthView Services – Health/Wealth Link

BY THE NUMBERS

LIMITED INCENTIVES TO RETIRE — IN THE CONTEXT OF LOW GROWTH AND A "BUILD" TALENT STRATEGY — RESULT IN LOW INTERNAL LABOR MARKET VELOCITY, SIGNIFICANT CAREER CHOKE POINTS, AND A SERIOUS DRAIN OF TOP TALENT



Source: © 2014 Mercer

WHEN YOU IMPLEMENT AUTO ENROLLMENT, WHICH EMPLOYEE GROUPS WERE INCLUDED IN THE ROLLOUT?

	PLAN SIZE									
	Overall	<1MM	$1MM-$5MM	$5MM-$10MM	$10MM-$25MM	$25MM-$50MM	$50MM-$200MM	$200MM-$500MM	$500MM-$1B	>$1B
New/Future employees	90.5%	65.7%	88.7%	91.7%	93.0%	93.2%	91.7%	91.7%	90.7%	92.0%
Existing employees not enrolled in plan	30.1%	31.4%	31.5%	28.6%	29.5%	34.0%	30.8%	28.6%	27.9%	30.7%
Employees enrolled in plan but contributing below the default rate (auto-boost)	14.9%	11.4%	6.5%	15.0%	16.0%	16.3%	17.2%	15.0%	7.0%	13.3%
Employees enrolled in plan but not invested in the QDIA	1.4%	2.9%	0.8%	0.8%	1.5%	1.4%	1.8%	0.8%	0.0%	1.3%
Other	2.9%	8.6%	3.2%	3.0%	1.0%	1.4%	4.1%	3.0%	4.7%	1.3%

Source: PLANSPONSOR 2014 Defined Contribution Survey.

‘Baby’ Steps

Behavioral design works best when difficult decisions follow a continuum of small, easy accomplishments.

BY SHERI FITS

For decades, the retirement industry has concentrated on improving the retirement readiness of American workers through financial literacy education. Workers receive a steady stream of logic-based data and terminology, tons of paperwork (literal or online), and quarterly statements.

Yet, despite the best intentions of many people, industries and companies, the annual household savings rate hovers at 3.8% and three-quarters of Americans do not have enough saved to cover six months of living expenses.[1]

So, why is the savings picture still so bleak? Unfortunately, the effort to promote savings focuses almost exclusively on appealing to the brain's frontal cortex. Retirement plan providers pay scant attention to eliciting an emotional response that can build confidence and retirement preparedness.

Behavioral Design Provides Relevant Framework

Plan advisors who work with participants know that getting people to overcome fear and inertia is a huge first step in retirement planning. To help understand this process more fully, academic researchers are now looking closely at the complex innate mechanisms by which people make decisions or pursue certain behaviors.

> "If people complete one small task, they come to *believe* in their ability to complete more difficult tasks."

Stanford University Professor BJ Fogg's Behavior Model (FBM), shown in Figure 1, suggests that for a person to perform a desired behavior, he or she must be sufficiently motivated, have the ability to perform the behavior, and be triggered to perform the behavior.[2]

Fogg believes that if you motivate people to complete easy-to-do activities (the lower right), you can use triggers to guide them along an "activation threshold" and tackle harder-to-complete tasks (such as saving 10 % of their salaries).

The issue we work to address in many enrollment meetings is motivation. Unfortunately motivation alone is variable. (Someone may have just received bad news about his or her cell phone bill as an example.) Making something *easy to do* is engineered into the solution — and is not variable. (Sound like auto enrollment?)

My take on why this approach works brings in another concept. If people can tackle a very simple task, they gain a greater sense of what psychologist Albert Bandura called self-efficacy — the confidence in the ability to exert control over one's own motivation, behavior and social environment. Put another way, if people complete one small task, they come to *believe* in their ability to complete more difficult tasks.

Improved Outcomes Rely on Building Confidence

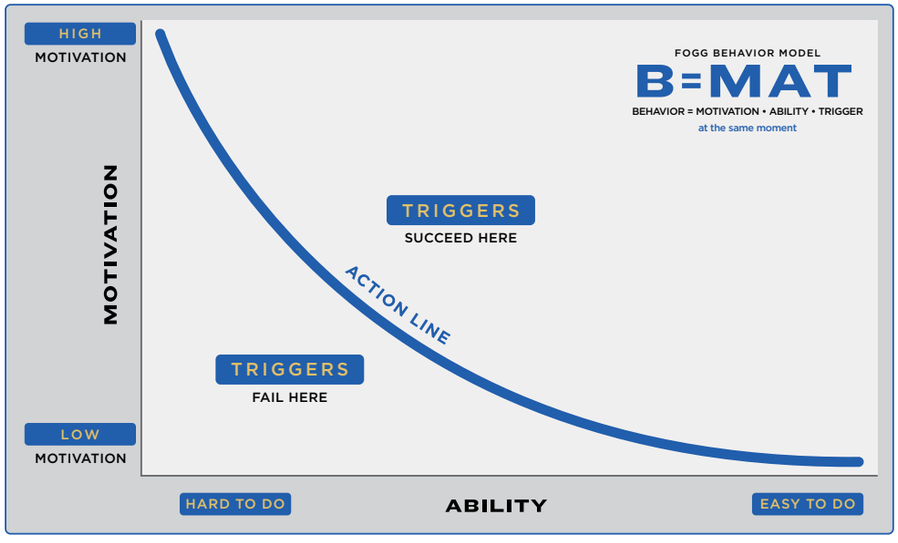
Today, several industry innovators — vWise, Commonwealth Financial and MassMutual, as examples — are using a variety of these behavioral principles to help workers take a more active role in financial planning.

To complement the traditional employee education methods, vWise, Inc. a Southern California software solutions provider, is leading the development of an intriguing participant engagement platform that implicitly employs FBM principles. vWise's software, SmartPlan, uses small, incremental triggers to get an employee to take specific action: watch a 90-second video, select a contribution amount, or choose or make investment adjustments — preferably during a single online session that occurs where and when the employee dictates.

What's unique about SmartPlan is that it's an interactive experience designed to provide *motivation, ability and triggers* to average American investors in a "just-in-time" sequence.

The outcomes-based philosophy behind SmartPlan asserts that financial literacy levels do not predict how actively employees engage with their plan. Instead, the software provides workers with

FIGURE 1: FOGG BEHAVIOR MODEL



Source: © 2007, Dr. BJ Fogg, behavioralmodel.org. Used with permission.

1 "Another Penny Saved: The Economic Benefits of Higher US Housing Saving," Oxford Economics, http://www.asppa.org/Portals/2/PDFs/White%20Papers/Another%20penny%20saved_FINAL.pdf.

2 BJ Fogg. (2009). A behavior model for persuasive design. Claremont, California: Persuasive '09 (April 26-29).

> Emotions play a huge role in either helping or hurting an otherwise sound investment or savings strategy."

motivating triggers to enter information that generates interest and excitement about their own personal outcomes, and thereby encourages them to join their workplace retirement plan and begin investing.

For Jeremy Katz, a financial advisor with AXA Advisors, SmartPlan helps employees make good decisions. "By viewing short one- or two-minute video vignettes, employees uncover personally relevant information that leads them to take a small action, whereas a typical plan website requires them to click through many more pages that communicate on a far more generic, and to my mind less effective level," adds Katz.

Small Steps and Accomplishments Create Action

Behavioral design works best when difficult decisions follow a continuum of small, easy accomplishments. Commonwealth Financial Network recently implemented a simple seven-question, multiple choice, survey for use at the beginning of retirement plan enrollment meetings. The survey was designed to accomplish two things:

1. Build a sense of accomplishment — self efficacy — at the outset of the meeting by having employees complete an easy-to-do task.
2. Elicit personal responses from employees regarding how they feel about investing for retirement with phrases such as: *Are you confident? Are you comfortable?* Employees may not intuitively understand their risk tolerance. Many people are able to express how they feel about an issue, particularly when they are prompted with multiple-choice answers.

The survey uses behavioral design and adult learning theory to establish a diverse employee group confidence baseline. Then, the meeting design uses a series of effective "triggers" to move employees up along the activation threshold to motivate them to enroll in the plan or add to their savings.

"Making the presentation personal to each participant is absolutely the key to getting them to engage," explains John Higgins, a Wealth Manager and Retirement Plan Consultant with Commonwealth. "Plan sponsors get a surge in interest in the plan when employees use this personalized approach."

Investing is Both Rational and Emotional

While many people agree that investment decisions are best made based on reason, emotions play a huge role in either helping or hurting an otherwise sound investment or savings strategy.

The Society for Grownups, developed by MassMutual and IDEO, operates as a Master's Program for Adulthood, is trying to bridge the gap between the head and heart to improve financial well-being.

Not surprisingly, the Society primarily targets Millennials, a group that is often unfairly accused of putting off financial planning. By offering small, in person salons on subjects such as Investing & Fine Wine, the Society for Grownups draws similarities between the familiar and unfamiliar, the emotional and logical, and in so doing seeks to draw a distinction between the comfortable and unknown. Their approach provides for a super easy and enjoyable way to discuss and discover the world of finance. (Head over to societyofgrownups.com for some awesome examples of approaching the Millennial marketplace.)

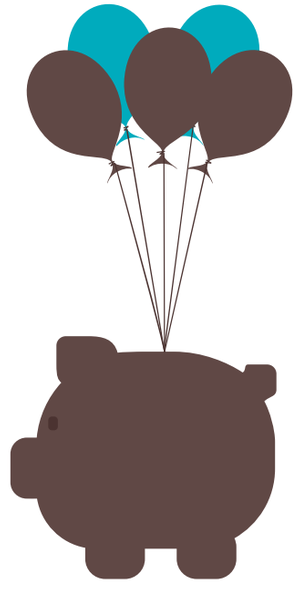
Retirement plan providers and advisors have long looked for viable ways to crack the code for encouraging greater levels of engagement and contributions to their plans. These innovative behavior-based education models show great promise. The tide for participant outcomes finally could be turning.

»Sheri Fitts is Founder of ShoeFitts Marketing, a nationally based financial services consulting firm based in Portland, Ore.

IMPROVING OUTCOMES

Behavioral design follows a model that invites — rather than demands — a user's active participation and engagement using three key principles:

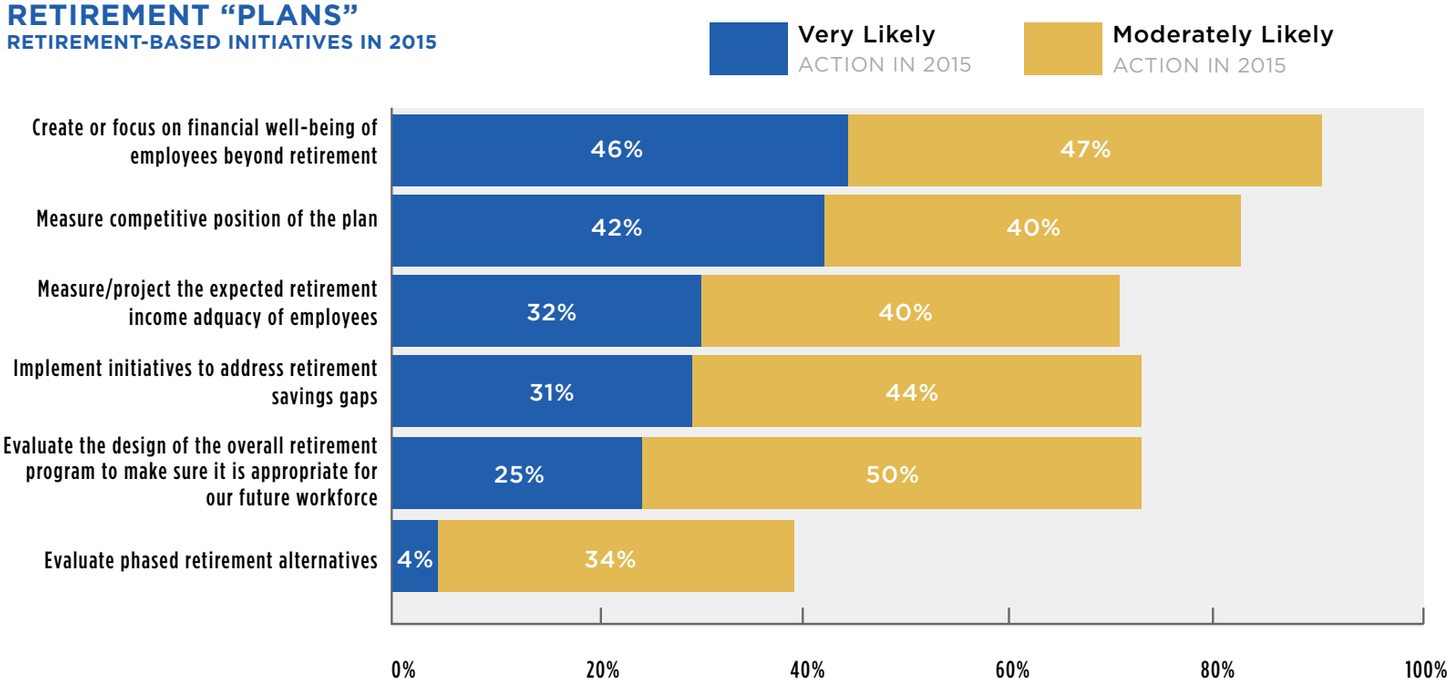
- Soliciting real-world information about an employee's personal situation and preferences lessens common motivational frustrations about financial education and plan engagement.
- "Just-in-time" bite-sized delivery of information helps improve the user's confidence level — a far better predictor of action than his or her level of financial literacy.
- Specific triggers, properly sequenced along the 'activation threshold,' can greatly improve the motivation (and self-efficacy) and guide them to taking desired action.



BY THE NUMBERS

RETIREMENT "PLANS"

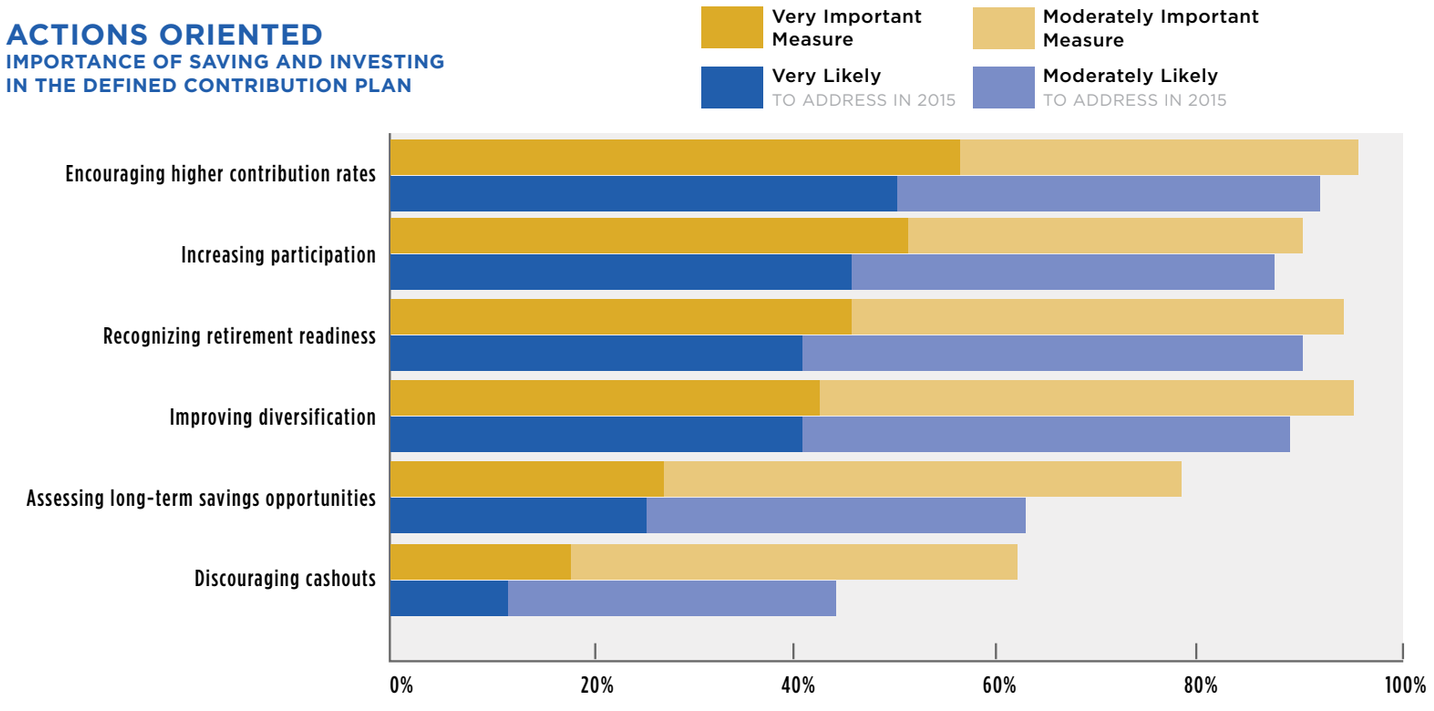
RETIREMENT-BASED INITIATIVES IN 2015



Source: Aon Hewitt, 2015 Hot Topics in Retirement

ACTIONS ORIENTED

IMPORTANCE OF SAVING AND INVESTING IN THE DEFINED CONTRIBUTION PLAN



Source: Aon Hewitt, 2015 Hot Topics in Retirement

‘Know’ How

Showing people where they stand on the road to retirement readiness can drive better savings and better outcomes.

BY PATRICIA ADVANEY

Would people save more for retirement if they knew their current rate of saving was inadequate? Intuition tells us many people would. And now, so does the data.

Surveys have long shown that people who say they have a good handle on their retirement readiness are also more likely to say they engage in "good" saving behaviors. Today we have numbers to validate their story. A representative sampling of defined contribution plans administered by Transamerica finds that participants who have viewed a personalized retirement outlook — an assessment of their retirement readiness that can be calculated quickly, online — are saving on average 6.44% of their salaries for retirement. By contrast, those who have not viewed a retirement outlook are saving just 3.76%, a difference of 268 basis points.[1]

How significant is that? If we compound the savings over a 40-year career, assume average annual investment returns of 6%, and use a starting salary of $40,000 that increases 3% annually, the person saving more of their salary will end up with $259,000 in additional cash at retirement age. Plug in a $75,000 starting salary, and the difference becomes approximately $486,000.

Why do people who've viewed their retirement outlook save so much more than those who haven't? Perhaps it is for the same reason that people with maps are more likely to reach their destination than people who only guess where they're going. Information is empowering. It drives and enables better decision-making. An easy-to-grasp retirement outlook lets people know where they stand, even if the outlook is gloomy. It helps them take stock of their situation, and presents them with an opportunity to chart a new course.

Here's some proof. In a survey of plan participants last year, 55% of those who received a negative retirement outlook said it motivated them to develop a plan to enhance their retirement readiness. A third of the respondents actually increased their deferral rates, and 19% changed the way their plan assets were allocated. Another 17% consulted with a plan representative to explore options for improving their retirement outlook.[2]

"Why do people who've viewed their retirement outlook save so much more than those who haven't?"

The retirement outlooks that drove these behaviors were generated in some cases at the request of the individual participant and in others by the plan provider on the participant's behalf. Either way, each outlook became part of the participant's record and was subsequently conveyed to them multiple times in many different but always personalized ways — on their account statements, on the home page of their retirement plan website when they logged onto it, and via any mobile applications they used to access account information.

The Power of Engagement

Multiple points of contact like this are important because they promote the participant's engagement with their retirement plan, and engaged participants are more likely to achieve retirement success. Research shows, for example, that doing something as simple as sharing their email address with their plan provider is an indicator that a plan participant will save more for retirement. In one recent sample, participants who provided email addresses were deferring on average 8.41% of their income into their retirement plans, versus 5.61% for those who didn't supply an email address.[3] That's a difference of 280 basis points, and using the same parameters from our earlier examples — 3% annual salary increases and a 6% rate of return over a 40-year career — would result in nearly $271,000 in extra savings for someone who starts with a $40,000 annual salary. It would provide an additional $507,000 for someone starting their career earning $75,000 a year.

That average disparity, by the way, only tells part of the story. In some demographic groups, differences in saving rates were astonishingly higher. Among plan participants in the higher education market, those who shared email addresses were deferring 400 basis points more of their salary, on average, than their peers who hadn't shared an address. Among participants 70 and older in the corporate sector, the difference was 509 basis points. In fact, in three of the four sectors examined — higher education, corporate and manufacturing — the older participants were the more likely they were to be saving more if they had also shared their email address.[4] The only sector where that wasn't the case was in retailing.

These surprising findings reinforce the idea that email is the best way to engage retirement plan participants. Using email, plan providers are able to connect with participants and prompt them to take action in ways that paper communications simply don't allow, in part because email can be embedded with instantly actionable links while paper correspondence cannot. Providers also can more easily track how participants respond to email — how often they actually open their mail and how often they click through to take action — and this, too, can help providers refine their message to drive better saving and investing behaviors among plan participants.

1 As of March 1, 2015.

2 Q1 2014 Transamerica Retirement Solutions' Participant Survey of 2,073 participants selected at random.

3 Participants in defined contribution retirement plans for which Transamerica serves as record keeper, as of June 30, 2014.

4 Ibid.

Importantly, engaged participants don't just tend to be better savers, they also tend to be more goal-oriented, and that also makes a difference in retirement readiness. Our research has shown that participants with retirement income goals defer a higher percentage of their earnings into their retirement savings plans, have higher account balances, and are more likely to be on track to reach their retirement goals. They also are more likely to read educational materials relating to retirement planning, and to use retirement planning tools, including retirement readiness calculators.[5]

Form Counts

How participants receive information about their retirement outlook is just as important as how often. Effective retirement readiness scoring systems deliver complex information in simple and intuitive form. The system used for the surveyed plan participants illustrates their overall retirement readiness with a simple weather-themed graphic: a rain cloud for participants at greatest risk, a bright sun for those in the best shape, and "cloudy" and "partly sunny" graphics for those in between. The goal of this sort of simplicity is to inform and educate without intimidating or overwhelming participants. To promote action, these simple messages are accompanied by a list of measures participants can take, sometimes with a few clicks on their computer, to immediately begin improving their retirement readiness.

Although many factors play into a retirement plan's success, none is more important than ensuring that participants save at adequate levels. Providing participants with simple-to-understand retirement readiness scores on a regular basis, and utilizing email campaigns that make it easy for participants to refine their saving and investing behaviors, can go a long way toward helping them map a route to retirement success.

» Patricia Advaney is Senior Vice president, Customer Experience, for Transamerica.

5 Q1 2014 Transamerica Retirement Solutions' Participant Survey of 2,073 participants selected at random.

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It's Good to be Better

Companies that offer automatic enrollment also tend to offer or seriously consider more features associated with plans that take a more hands-on approach.

BY RICHARD DAVIES

What's the real point of having a defined contribution plan in the first place? That's the big question plan sponsors needs to ask themselves. If the answer is helping employees achieve better retirement outcomes, then the DC plan can't just be good; it's got to be better.

More than any other success metric, DC plan sponsors want to have employees feel confident about their prospects for a comfortable retirement. That's what more than 1,000 plan sponsors told us in our most recent survey (a balanced representation from across the full universe of DC plan sizes) fielded in 2014.

But how can you make that happen? That nagging problem has not been resolved by participant education, more investment options or even better investment choices. All of those may be good to have, but too many employees aren't well diversified, aren't contributing enough or aren't in the plan at all.

The answer frequently lies with implementing automatic features: automatic enrollment in the plan and automatic escalation of participants' contribution rates.

And many plan sponsors have arrived at that conclusion already. Overall, 55% of our respondents use automatic enrollment. This is similar to an AonHewitt's survey that found the percentage of plans offering automatic enrollment has risen from 34% in 2007 to 59% now ("2013 Trends & Experience in Defined Contribution Plans," AonHewitt, 2013).

Automatic enrollment boosts participation — plain and simple. But it's interesting to see how much of a difference it makes: two-thirds of plans that use automatic enrollment have participation rates above 70%, while just under half of plans that don't use it have that level of enrollment.

Plan sponsors who offer automatic enrollment see it as something participants want. They're also more likely to think participants would prefer to have plan participation and saving rate decisions made for them. Companies that offer automatic enrollment also tend to offer or seriously consider more features associated with plans that take a more hands-on approach.

"Two-thirds of plans that use automatic enrollment have participation rates above 70%, while just under half of plans that don't use it have that level of enrollment."

They're more likely than their peers to offer a target-date fund, consider automatic escalation and show interest in adding a guaranteed income target-date fund.

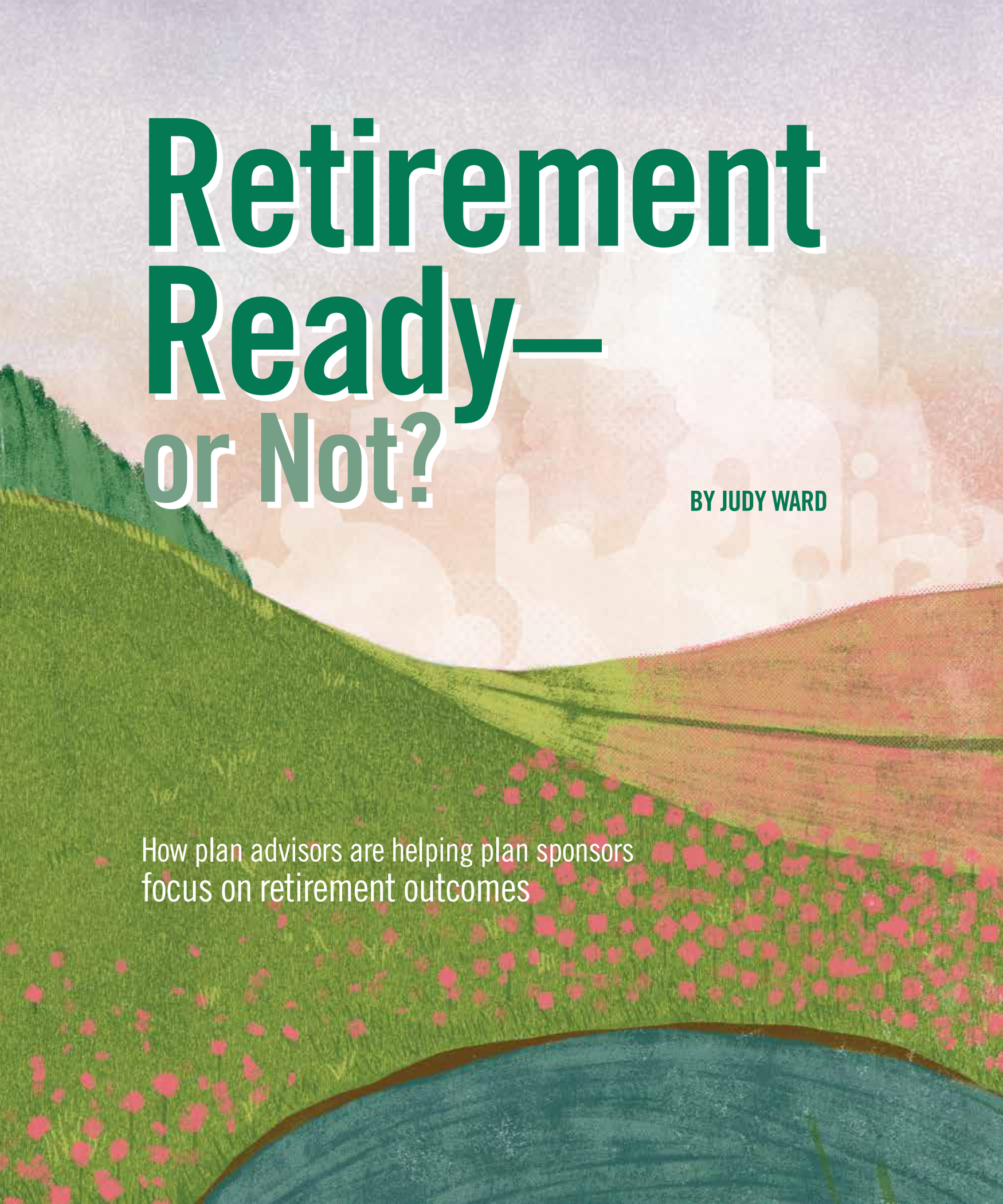
Interestingly, survey respondents whose plans don't offer automatic enrollment are more likely to say they don't have a default option in the plan and are more likely to believe a key measure of plan success is offering investment options that consistently outperform their benchmarks — a seemingly straightforward, but dubious, goal.

While automatic enrollment has certainly caught on, automatic escalation may still feel like a step too far for many DC plan sponsors. About one-third or our respondents use it, while the two-thirds who don't may feel it's too hands-on and overly paternalistic. But other studies have noted that plan sponsors often recommend a contribution rate of 10% for the average participant. That's a lofty goal, and probably unreachable without that hands-on help from plan sponsors.

It may be time for DC plan sponsors to reopen the philosophical dialogue about retirement outcomes with their company leaders and advisors.

» Richard Davies is Senior Managing Director—Defined Contribution and Co-Head North America of AB Institutional Investments.

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AB portfolio-management teams.



Retirement Ready—or Not?

BY JUDY WARD

How plan advisors are helping plan sponsors focus on retirement outcomes

"W

here do you think your employees are going to get the money to stop working?"

That's the simple, and yet very complex, question that advisor Peter Philipp likes to ask sponsors to start a conversation about retirement outcomes.

Sponsors usually respond that they think that money will come from a combination of Social Security and their participants' 401(k) accounts, says Philipp, a financial advisor at Newport Advisory in San Francisco. "Then it is a natural question to ask them, 'How much of participants' income in retirement do you think should come from the 401(k) plan?'"

That starts a broader discussion about the income-replacement ratio needed to retire comfortably, the likelihood that a plan's retiring participants will achieve it — and if many won't, how much the sponsor can and wants to do to change that. Most employers need an advisor's help gaining clarity on how responsible they feel for participants' end results, Philipp thinks. "They may not have even given this any thought," he says. "It's incumbent on us as 401(k) advisors to help them articulate that."

Asked in a 2014 poll by Wells Fargo Institutional Retirement and Trust of its recordkeeping clients about the goal of their workplace retirement plan, 54% of sponsors identified it as ensuring that employees have a secure retirement, 38% characterized it as a supplement to other forms of retirement savings, and just 8% saw their plan's purpose as providing a benefit to compete against company peers.

"Some sponsors are just starting to think about outcomes, since in the past they thought they needed a retirement plan because that's part of what it takes to attract employees," says Gregory Kasten, chief executive officer of Unified Trust Co., NA in Lexington, Ky. "But they had never thought about, 'Is the plan supposed to do something? And if it is supposed to do something, what is it supposed to do?'"

What's the Point?

As director of Wells Fargo Institutional Retirement and Trust, Joe Ready often has the chance to sit down and talk with plan committees. "One of my favorite things I like to do to start off the conversation — to get to a more strategic dialogue — is ask them, 'Your retirement plan that you offer: What's the point?'" says the Charlotte, N.C.-based Ready. "For example, a committee needs to decide if they view the 401(k) as a supplement or primary retirement benefit for employees." As a sponsor, he says, "You really need to be honest with yourself on that question. Your plan design, your actions, and how you measure the plan's success will be grounded in the answer."

Federal law doesn't explicitly say that sponsors have responsibility for participants' retirement outcomes. "There is no specific directive within ERISA that says plan sponsors have an obligation to make sure that participants are ready for retirement," says Alan Hahn, a partner at law firm Davis & Gilbert LLP in New York City. "But the issue sponsors and advisors are struggling with is, if there is not an express obligation to get participants ready for retirement, is there some implied responsibility?"

Today's employers have a wide range of feelings about their level of responsibility for employees to achieve retirement readiness, says advisor Joe Connell, director of retirement plan services at Sikich Financial in Maple Grove, Minn. "Some are very involved in that process, some are just learning about it, and some feel it is an area that they don't want to be involved in or to measure their plan's success on that," he says. "A lot of employers haven't even thought of why it should matter. [Advisors] should have that discussion with them, to figure out how much emphasis they want to put on it."

When advisor Brian Allen and his colleagues at Pension Consultants, Inc. talk with new plan sponsor clients, they ask right away about a sponsor's philosophy

> **"Our job is to give them the best results we can for the commitment the employer can make."**
>
> — Brian Allen,
> Pension Consultants, Inc.

on its responsibility for outcomes. "We ask them to characterize themselves into one of three buckets," says Allen, president of the Springfield, Mo. advisory firm. The first one he calls "Choice," and characterizes the sponsor mindset as, "We have a philosophy of offering a retirement plan to employees as a choice. If they want to take advantage of it, great. If not, that's their choice."

The second category he calls "Informed," which he describes as: "We feel an obligation to inform employees about the plan and its impact on their retirement readiness," but the employer doesn't feel responsible for retirement outcomes. He calls the third category "Ready" and explains the philosophy as: "We really have a paternalistic philosophy, and our goal is to make sure that our employees are ready for retirement."

An advisor also can help an employer gain clarity on its philosophy by seeing the larger factors at work. "It's partly a matter of where the company is in the different stages of the business cycle," says advisor Carmela Elco, managing director at Blue Prairie Group in King of Prussia, Penn. Startups tend to have different priorities than mature businesses, and those priorities often shift over time. "The word 'evolution' is important. It's always changing," she says. "You always have to look at the big picture, and understand in what direction they're going."

How responsible an employer feels also depends on the industry and the importance of other benefits to employees, Connell says. In some industries, for instance, employees may value their medical benefits the most, so an employer might choose to provide very good health care coverage, and offer a discretionary 401(k) match. The retirement plan's goals "have to be looked at in the context of the whole benefits package," he says.

At the same time, advisors can help employers thinking about their responsibility see the bigger picture on the potential consequences for them if employees don't save enough for retirement.

Ready often talks with sponsors about mounting evidence that many American workers will not be able to retire at age 65. According to the 2014 "Wells Fargo Middle-Class Retirement" study, 33% of middle-class Americans say they will need to work until at least age 80 because they will not have enough retirement savings — and that percentage jumps to half for those in their 50s. "You should know that the evidence is starting to suggest that many people will not leave the workforce at a normal retirement age, given that many will not be ready financially, and you need to factor that into your forecasts of your future expenses," Ready tells employers. Particularly when he's talking with CFOs, he adds, "That starts to connect the dots for them as to why overall employee retirement readiness is an important plan measure."

> **The issue sponsors and advisors are struggling with is, if there is not an express obligation to get participants ready for retirement, is there some implied responsibility?**
>
> — Alan Hahn, Davis & Gilbert LLP

Philipp also finds that reality check effective. "We don't start here, but ultimately we wind up with this idea of, 'Well, what's going to happen to your employees who aren't ready for retirement? They're going to keep working, and they probably will keep working for you,'" he says. "That has plusses and minuses. You get to retain that knowledge, but an aging workforce may increase an employer's health care expenses."

Beyond the workforce-planning implications, Kasten raises the additional possibility of future participant lawsuits over sponsor responsibility for outcomes. "I don't believe that the courts will ever mandate something like, 'Everybody in a retirement plan is supposed to be able to replace 70% of their income,'" he says. "But I do believe that the courts will slowly move toward the new frontier of, 'Do you have in place a plan that has a reasonably good chance of providing an adequate benefit to your participants?'" So an employer that implemented auto enrollment at 3% with no escalation could be vulnerable, he thinks, since that has virtually no change of producing adequate savings. "Maybe it's not a 'bright line of success' test that will emerge, it's a 'bright line of failure' test," he says.

Hahn doesn't see a big risk of sponsors losing future lawsuits over participant outcomes on the basis of plan design, if the sponsor is otherwise doing its job. In terms of the possible "implied responsibility" for outcomes in ERISA, the overarching issue is whether sponsors did enough to explain both the plan and their individual retirement savings outlook to help employees make the right choices, he says. On the macro level, that means explaining to employees "how the plan is meant to get them from point A to point B," he says. On the micro level, it means giving participants projections of what they might need in retirement, and what they're on track to actually have. "It comes back to what the plan design really means on an individual level," he says.

Defining Success

Once sponsors have defined their priorities, they should figure out how that translates into defining plan success. For sponsors focused on offering a competitive plan that helps them hire and keep the employees they want, Ready says, "then that committee's time may be spent on asking, 'Do we have good investments, and are they cost-effective?' The committee may spend 75% of its time on that."

For a sponsor that wants to focus more on participant outcomes, Connell suggests that an advisor can start to help by getting data from that plan's recordkeeper to do an analysis of the plan's health. "We look at all the data and pare

PLAN SPONSORS, ADVISORS DIFFER ON PLAN SUCCESS MEASURES — NEVIN E. ADAMS, JD

You hear a lot of talk these days about measuring plan health, retirement readiness and plan outcomes.

Realizing that each plan can have its own measure of success, in early April, NAPA Net readers were how their plan sponsor clients measure plan success — and how that compares with the measure(s) they use.

Participation, Rated

Nearly 4 in 10 (37%) respondents said that participation rate was the measure of success for their plan sponsor clients. However, the second-most cited response was projected retirement income replacement rate(s) — though it was cited by only 17%.

The deferral rate of various demographics (highly compensated versus non-highly compensated) was third-most cited, at 12%, and projected monthly retirement income was fourth (8%). Finally, participants saving to the level of the match, plan design feature benchmarking and — well, no particular method of measurement rounded out the responses.

Income Oriented?

The picture was quite different from the advisor perspective. The most cited measure used by survey respondents was projected retirement income replacement rates, cited by nearly 42%, and the second-most cited response (21%) was projected monthly retirement income. As one advisor noted, "anything that gets measured can be improved, so I love to see plans at least measuring something, but in my experience the replacement of income at retirement is the best way to improve the entire country."

Plan design feature benchmarking (12%) rounded out the top three, with participation rate, deferral rates of various demographics, increase in deferral rates and plan design feature benchmarking rounding out the responses.

Measures Measured

Nearly 55% of respondents said their recommended measure had changed over the past five years; just under 17% said it hadn't. Among those had shifted, the move had clearly been toward projected retirement income, and that shift was clearly enabled by the advent of new technologies. One advisor explained, "Our measure has migrated from simple plan participation, average and median contribution rates to projected monthly income. This migration is due primarily to our increased use of available technology to "crunch the numbers" on income replacement." Another said, "Technology has allowed us to shift to measuring success for plans by way of determining who is fully funded versus the underfunded group and then measure progress. Five years ago, we were just beginning to do this work, today it is a primary deliverable."

Other respondent insights:

- "Every plan has its own metrics, making it difficult/impossible to use a check-box approach. I look for the weak spots in each plan, and solve for that; success for one plan may be completely different for another."
- "In the past, there was so much focus by employers to compare fund performance and fees to determine if they had a 'good plan.' But a cheap lineup of high performing funds won't help if employees aren't utilizing the plans."
- "Plan utilization needs to be addressed. Above and beyond participation, we need to think about how plan sponsors can utilize all the provisions in a qualified plan to promote and provide retirement readiness for their employees."

One reader summed it up like this: "I find it interesting that most of the market discusses retirement readiness, but still places a lot of the responsibility on the sponsor or participants to actively participate when it has been demonstrated time and again that clients need to have as much done for them as possible. Will be interesting to see if the market will adapt accordingly or, in five years will it still be about investments (nothing really ever changes)."

it down for the sponsor to a useful three to five statistics that particularly help drive the participant outcome," he says. Four data points often make for a good focus for sponsors to try to improve: the participation rate, deferral rates, investment diversification, and most importantly, projected income replacement ratios. He adds that advisors should not just do a plan-level retirement readiness estimate, but also do projections for different demographic groups, such as participants age 45 and older.

For outcomes-focused sponsors, advisor Vincent Morris says that Bukaty Companies Financial Services does a two-part customized analysis. First it estimates the average replacement ratio that a plan's participants will need in retirement, says Morris, the Leawood, Kan.-based president of Bukaty. That calculation includes factors such as projected future wage increases, a demographic analysis of the workforce, and projections of future inflation rates and market returns. "Second, we look at the population as a whole and do an analysis of, how many people are projected to cross that line?"

Unified Trust works with sponsors to put together a plan's "benefit policy statement," which Kasten calls a sister document to the investment policy statement, that spells out what outcomes a sponsor wants its plan to achieve. "If you want to manage outcomes, you are going to have to measure outcomes — and go a step further and define the outcomes you want," he says.

Helping sponsors focus more on optimizing participant results does have its challenges. Plan committee members sometimes feel reluctant to document a specific goal for 401(k) participant outcomes, Philipp says. "They wonder, 'Should we as an employer be taking the lead in that? We come back with, 'Well, who should be taking the lead?'"

Documenting retirement outcome goals at the fiduciary level likely doesn't pose a big legal risk for sponsors, Hahn says. "The way that ERISA looks at satisfying fiduciary obligations is that it's largely an issue of employing a process in making decisions, and documenting that process," he says. "Rarely is there a case when documenting

> "It's always changing. You always have to look at the big picture, and understand in what direction they're going."
>
> — Carmela Elco, Blue Prairie Group

something gets you in more trouble. You probably have a greater exposure in not documenting it."

Employers' financial constraints present another challenge. "There is also the dollars-and-cents aspect of it," Morris says. Some employers presented with the chance to improve outcomes by taking a step such as increasing their match may say, "We just can't afford to do that," he says. Many business considerations go into how responsible an employer feels for getting employees ready for retirement, Allen says. As advisors working in areas such as participant education, he adds, "Our job is to give them the best results we can for the commitment the employer can make."

When talking to sponsors about how to optimize their plan for participant outcomes, Elco finds they rarely if ever can implement every step in one fell swoop. "It's usually step by step," she says. "It's a matter of helping them work within the parameters of what they can actually accomplish at any given time. You can't just say, 'Let's give them all a 100% replacement ratio.'"

» Judy Ward is a freelance writer who specializes in covering retirement plans.

HOW DO PLAN SPONSORS MEASURE SUCCESS?

When plan sponsors were asked how they felt their organizations did on several key plan success measures, overall participation rate ranked highest, and was most commonly measured. Participant outcomes did not fare so well.

Regarding overall participation rates as a measure, 18% of plan sponsors said they did an excellent job with it; 38% felt they did a "very good job" and 31% a "good job." Just 4% felt they did a poor job here, and 8% a "fair" job. Nearly all (83%) of respondents formally measured overall participation rate.

On the other hand, only about a quarter (28%) of the 310 plan sponsor respondents to the survey of plan sponsors by American Century formally measure how ready employees are for retirement. Still, one-in-twenty feel they are doing an excellent job here, 17% a very good job, and nearly one-in-four (39%) a good job. Just 7% say they are doing a poor job, but one-in-ten admit they don't know.

Success Measures

Nor do plan sponsors appear to be concerned about their accountability for those participant outcomes. Asked about their level of concern that employees might sue if they don't achieve the results they feel they should, nearly two-thirds (63%) said they were "not concerned." Only 7% were "very concerned," and 27% were "somewhat concerned."

Among the other measures of plan success:

- 81% formally measured the percent of eligible employees taking full advantage of the match; 19% thought they did an excellent job in that area, 34% a very good job, and 31% a good job. Fewer than 3% think they do a poor job here.
- 72% formally measure the general contribution rate. However, only 11% think they do an excellent job here, while 35% claim to do a very good job, and 38% say a good job. Again, fewer than 3% think they do a poor job here.
- 68% track the participation rate of NHCEs, with 16% saying they do an excellent job here and 31% a good job; slightly more (32%) say their execution level is good. Poor performance here was admitted by just 4%.
- 61% monitor the percent of employees who contribute the maximum, with 9% saying they do an excellent job with this, 28% a very good job, and 35% a good job. Six percent say they do a poor job in this area.

Goals Oriented?

Somewhat ironically in view of the success measures, when the plan sponsors were asked to rank the importance of several corporate goals associated with offering a retirement plan, "supporting employees' efforts to have a secure retirement" topped the list, cited as being "extremely important" by 62% of respondents (and 30% as "very important"), just outpacing the 54% who opted for the traditional "attracting and retaining workers" (and 38% who said that was "very important").

As for assessing the success of their retirement plan, 38% cited as "extremely important" the percentage of employees taking full advantage of the match, just ahead of the 37% who cited "the overall participation rate." Both categories also ranked highly (19% and 18%, respectively) on the factors that plan sponsors said they felt their company does well in achieving, given their industry and employee population.

As for other success factors, roughly a third (32%) said that the participation rate of non-highly compensated workers was "extremely important," while 30% cited employees' self-reported satisfaction with the plan.

Just 28% said that how ready employees are for retirement is "extremely important" (though another 47% said that factor was "very important." The general contribution rate (24%) and percent of employees who contribute the maximum (17%) were also on the "extremely important" list.

A total of 310 plan sponsors were surveyed, representing plan assets of less than $25 million to $100 million.

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03

THE **OUTCOMES** ISSUE

PLAN METRICS:
What's Measured Matters

The measure of success in DC plans has long been the rate of participation — a significant benchmark in a time when plan sponsors have tried to counter a consumer culture that encourages spending, not saving. Not only did measuring success through the prism of participation make sense, it was a true indicator of both the attractiveness of the benefit and the impact of the accompanying education message. If it was not necessarily something that the plan sponsor could control, it was nonetheless something that the plan sponsor could at least influence. And in any event, the constraints of the various non-discrimination tests provided ample motivation for the focus on participation rates.

Via a combination of education initiatives and the lure of the company match, over the years most DC plans managed to persuade more than two-thirds of eligible workers to take advantage of their workplace retirement plans.

Industry surveys indicate that the participation rate remains the dominant plan success metric today, although with the advent and growth of automatic enrollment, it seems less relevant than it once did. Perhaps as a consequence, a small but growing minority of plan sponsors, encouraged by advisors and providers alike, are looking to benchmark plan success against a broader range of factors, including what, for participants anyway, may be the ultimate outcome: retirement income.

Whether founded in the notion of projecting a retirement balance accumulation or, more recently, estimating what that projected retirement balance would produce in terms of retirement income, the focus is shifting.

In the pages that follow, you'll find perspectives on the importance and impact of these success measures, including:

The Effect of a Gauge

What participants are looking to buy from us is "retirement."

BY MICHAEL KILEY

When I was a 10-year-old boy, I remember getting a phone call at our house from a family member: "Truck's broke down on the side of the road." My dad was a man who saved most of his words for joke telling (endless) and few for "learning." He much preferred to teach by asking questions and then expecting you to respond with action.

As we walked out to our car, he grabbed one screwdriver, one pliers and one gas can which we filled on the way to the broken down 1956 pickup truck.

When we arrived, my relative quickly rattled off all of the sophisticated sounding parts that he had checked to determine why the truck had died. After hearing the list, my dad asked a simple question: "Is there gas in the tank?" My relative, knowing my tough and practical dad, answered "yes" with a satisfied look. Dad checked the fuel gauge — it in fact read "full." He tilted the seat forward to expose the gas tank. (Did I mention this took place a while back?) He gave the gas tank a firm bump with his fist and received a very informative, hollow sounding "BONG" in return. Wordlessly, I retrieved the gas can from our trunk and poured its contents into the tank. My dad — equally silent — fired up the truck with the first turn of the key.

"But the gas gauge read *full*!" was the protest — to which my dad asked, "When was the last time you put gas in the tank?" "Two weeks ago," was the solemn reply. My dad then asked a simple but profound question: "If you're not putting gas in the truck, why would you expect there to be gas in the truck?"

As we drove away, I noticed Dad looking in the rear view mirror and suppressing a smile. I looked out the back window and saw the wife of this relative and their young children driving the truck down the road toward their home — while this relative was walking down the shoulder of the road in the same direction.

Gas Gauges and Savers

We need to offer our participants a gas gauge that equates, "How much gas do I have in the tank?" to "How much 'retirement' have I got?"

I submit to you that by successfully doing that together, our industry will help everyone in the system: manufacturers, distributors, plan sponsors (be they MEP or individual) and, most importantly, the people we all serve — the plan participants.

Today, we give our participants statements that answer the question, "How much account balance have I got?" It doesn't matter if it's mutual funds, collectives, ETFs — it's a representation of the funds we sell, partner with and manufacture.

When really, what they want to buy from us is "retirement."

The conversation we're having today sounds like, "Bill, 31 years from now you're projected to have a monthly income of $1,187." This is information — *but it doesn't help*.

> We can all save ourselves a lot of angst if we reduce our conversations with our savers to a gas gauge."

Instead, we need to change the conversation: "Bill, at your current savings rate you can maintain the lifestyle you have today for one year and two months when you retire and *then you need to learn to live on Social Security*." Or, "Bill, if today were your 67th birthday, you could enjoy your current lifestyle until the first part of next year." This gets a reaction.

Could a Simple Gadget Save the Saver?

It was my dad's philosophy that if you could start a truck, very few things would actually keep the truck from running. The primary obstacle would be the driver. Only occasionally do the basic parts actually break down and keep the truck from moving once it's started.

The single biggest determinant of saver success is whether or not the saver is putting gas in the tank. We need to make, "How much retirement have I got?" visible to them and we need to agree as an industry how to measure that and talk about it.

The gas gauge has to become readily visible and available to our savers. We can have all the other gauges available; we do an excellent job at that with fund fact sheets, allocations, pie charts, etc. But the conversation needs to start with the gas gauge.

The businesses where we buy our clothing, household goods and entertainment don't want a market full of customers with no gas in the tank. Our governments don't want to run on taxes from people with no gas in the tank. And businesses don't want to try to grow surrounded by people with no gas in the tank.

The Gas Gauge and the 'F' Word

Today, we are hearing the word "fiduciary" a lot. I submit to you that we can all save ourselves a lot of angst if we reduce our conversations with our savers to a gas gauge. Everything that a participant and a plan sponsor does will either put gas in the tank or take gas out of the tank. For example, automatic enrollment helps fill the tank, while hardship withdrawal or failure to rollover empties the tank.

As a provider — manufacturer, distributor, financial advisor, broker, agent, TPA or otherwise — would you rather be judged on your ability to successfully help 1,000 savers to understand expense ratios "to or though" target date funds, alpha, indexes, etc. — or would you rather have your success measured by your ability to teach 1,000 people how to use a gas gauge, and then let them add or burn as much fuel as they want?

Would you rather make a living teaching people who are not interested how to "seek alpha" or would you rather make a living providing people with a gauge they can read, along with your phone number to call?

Participants have different journeys. Let's equip them to own that. Participants don't want to be told, and should not be told, how much retirement is right for them. They should be given a gauge that enables them to decide for themselves.

I've lived the heartbreak of enrolling

a participant who told me, "No one in my family has ever lived to be 70." I've been astonished to sit with super savers who saw that they are on track to "own" 27 years of retirement and immediately took steps to buy more because they were bothered it wasn't enough. I've also met that guy who is 70 years old on his way to a football game with his 90-year-old father who smiles and says, "Retire? Nuts!" (Which is that generation's way of saying "WTF" — and no, that does not stand for "Who's the Fiduciary?")

Let's equip them all.

'MPG' Won't End Us, It Will Grow Us

As an industry, we can, and will, deliver different "MPG" just as the auto manufacturers do. Some of us will offer high-powered luxury packages and others more economical solutions. Both are appropriate, valuable and necessary in the marketplace.

What's frustrating is when someone thinks they are buying luxury and in fact are buying economy — or vice versa. A gas gauge will help make them better buyers. Better buyers *always* mean *more* buyers.

> "Outcomes are the right focus. A gas gauge will allow us to be the heroes we always have been."

The Power of this Industry

I've been in this industry for 31 years and for a while it was exciting and fun. But for too long now, we've been speaking in funereal tones about the limits we face.

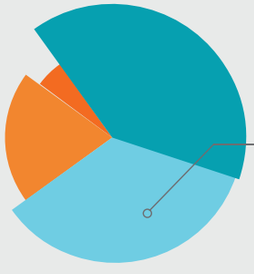
When I recall that boyhood story, I don't think so much about my relative on the side of the road who walked home, perhaps to a cold dinner. Instead I get a chill when I think of a saver left on the side of the road who "ran out of gas" for lack of a gas gauge.

Fortunately, we are about to have a lot of fun — and add a ton of value in the process. That pickup truck in the early part of this story now uses satellite connections and databases to find the next gas station, hotel or restaurant. It also will keep a list of the driver's favorite music and play it by voice command. Won't it be great when we are bringing those kinds of benefits to our customers?

Outcomes are the right focus. A gas gauge will allow us to be the heroes we always have been. Let's have some fun!

» Michael Kiley is the President/Owner of PAi.

To understand retirement, you need a clear gauge.



"31 years from now, you are projected to have a monthly income of $1,187."

VS

"If today was your 67th birthday, you could enjoy your current lifestyle until the first part of next year. Then you'd need to rely on Social Security."

THE **OUTCOMES** ISSUE

BY THE NUMBERS

DO YOU USE AUTOMATIC ENROLLMENT?

	PLAN SIZE									
	OVERALL	<$1MM	$1MM–$5MM	$5MM–$10MM	$10MM–$25MM	$25MM–$50MM	$50MM–$200MM	$200MM–$500MM	$500MM–$1B	>$1B
YES	40.0%	17.2%	20.0%	34.3%	45.2%	48.0%	55.4%	60.3%	64.9%	65.2%
NO	55.9%	70.2%	71.6%	62.7%	52.9%	50.5%	44.1%	39.0%	34.4%	34.8%
DON'T KNOW	4.0%	12.6%	8.4%	3.0%	1.9%	1.5%	0.5%	0.7%	0.7%	0.0%

Source: PLANSPONSOR 2014 Defined Contribution Survey

WHICH OF THE FOLLOWING MEASURES DO YOU USE TO GAUGE SUCCESS OF YOUR DC PLAN?

	PLAN SIZE									
	OVERALL	<$1MM	$1MM–$5MM	$5MM–$10MM	$10MM–$25MM	$25MM–$50MM	$50MM–$200MM	$200MM–$500MM	$500MM–$1B	>$1B
PARTICIPATION RATE	68.4%	41.1%	58.0%	69.7%	74.7%	73.4%	77.3%	78.9%	81.0%	80.3%
DEFERRALS OF VARIOUS EMPLOYEE SEGMENTS (E.G., HIGHLY VS. NON-HIGHLY COMPENSATED)	34.1%	13.2%	23.3%	34.3%	42.2%	42.4%	41.3%	38.9%	42.3%	43.6%
% OF PARTICIPANTS SAVING TO MATCH	28.4%	16.5%	23.6%	23.1%	29.0%	28.5%	32.7%	38.0%	39.9%	45.6%
PROJECTED MONTHLY RETIREMENT INCOME (I.E. $X PER MONTH IN RETIREMENT)	4.4%	2.6%	2.9%	2.6%	3.1%	4.1%	5.9%	6.7%	9.2%	11.1%
PROJECTED RETIREMENT INCOME REPLACEMENT	6.1%	3.5%	2.5%	3.0%	5.2%	6.3%	8.8%	9.6%	11.7%	18.4%
% OF PARTICIPANTS WITH "APPROPRIATE" ASSET ALLOCATIONS (I.E., CLOSE TO TARGET-DATE FUND GLIDE PATH, ETC.)	15.5%	6.5%	5.3%	10.0%	14.7%	18.2%	23.4%	27.5%	30.1%	36.7%
% OF PARTICIPANTS WHO INCREASED DEFERRAL RATES IN THE PRIOR 12 MONTHS	9.1%	3.9%	6.3%	9.0%	10.8%	8.8%	11.6%	11.1%	15.3%	12.8%
% OF PARTICIPANTS USING ADVICE TOOLS/SEMINARS OFFERED THROUGH THE PLAN	10.7%	3.0%	4.6%	7.7%	11.8%	11.9%	14.6%	18.1%	22.7%	22.3%
EMPLOYEE SATISFACTION SURVEYS	20.1%	14.2%	19.4%	22.1%	23.1%	19.3%	20.2%	19.3%	20.2%	21.6%
EXTERNAL/COMPETITIVE BENCHMARKING OF PLAN DESIGN	25.8%	6.7%	14.9%	23.0%	27.4%	30.9%	34.4%	37.1%	42.9%	45.2%
HAVE NO FORMAL PLAN SUCCESS MEASURES	25.8%	50.1%	36.4%	24.6%	22.1%	19.3%	16.5%	15.5%	13.5%	14.1%

Source: PLANSPONSOR 2013 Defined Contribution Survey. Used with permission.

PLAN METRICS:
WHAT'S MEASURED MATTERS

Measuring Inputs and Outcomes

Which retirement variables truly drive retirement outcomes?

BY TOM KMAK

Baseball season is upon us, and with it comes a flurry of statistics. Not only do we get the daily box score of runs, hits and errors, but we now get to enjoy things like on base percentage for hitters and earned run average for pitchers.

And it doesn't stop there. An entire new community of statistics called "Sabermetrics" has arisen to further differentiate one team or one player from another. Sabermetrics was made popular by the movie *Moneyball* — a movie that in my opinion is much more about innovation than it is about baseball statistics.

This obsession with statistics or metrics in baseball is best exemplified when you watch ESPN and hear something like the following: "That is the first time since 1987 that someone has hit to right field four times in a row when facing a left-handed pitcher in the month of May when the temperature was above 83 degrees" … which feels both truly obscure and relatively meaningless (only because it is).

The Outcome of Outcomes

As someone who has been in this industry for more than 30 years, it is a pleasure to see the incredible attention being placed on retirement outcomes. This focus should be somewhat expected given the "exclusive benefit" rule from ERISA, which states:

> *A qualified retirement plan is required to be maintained for the exclusive best interests of the participants and beneficiaries and payment of reasonable administrative expenses.*

TABLE 1
RETIREMENT ASSUMPTIONS

RETIREMENT VARIABLE	ASSUMPTION
Salary	55,00
Wage Increase	3.00%
Beginning Balance	$ -
Age	42
Employee Deferral	6.00%
Employer Match Ceiling	6.00%
Employer Match	50.00%
Earnings	7.11%
Fee	0.72%
Normal Retirement Age	67

> "…helping people retire well or even early will lead to lower labor costs, lower benefit costs, lower absenteeism costs and improved employee morale and engagement — *all of which are good for a company's bottom line.*"

So it is only natural that improving retirement outcomes would eventually become an area of intense focus for our industry. In addition, there is more and more research informing plan sponsors that improving retirement outcomes is not just a "feel good" thing — it is also good business. In essence, helping people retire well or even early will lead to lower labor costs, lower benefit costs, lower absenteeism costs and improved employee morale and engagement — *all of which are good for a company's bottom line.*

Thus, if you are a service provider and there is a "thing" that is "good" for both your plan sponsor clients and their participants, then it makes complete sense that you should care about that "thing." This helps explain the recent emphasis on retirement outcomes from service providers.

There is, however, a recent phenomenon that in my opinion has also accelerated this focus on retirement outcomes, and that is the other part of the ERISA exclusive purpose rule shown above: the focus on what are "reasonable" service provider fees.

Based on public information, it appears that more *$320 million* in lawsuits have been settled or awarded related to fee litigation of retirement plan service providers. In almost every one of these situations, there has been a reference to the impact that fees have on retirement outcomes. So let's run through a relatively simple example to see just how much you can improve retirement outcomes by cutting fees.

First, Table 1 shows some very simple assumptions that are relatively typical for our industry.

Based on these assumptions, this individual will have a retirement readiness ratio of about 94% in today's dollars (today's dollars can be easier for participants to understand). This is illustrated in Table 2.

TABLE 2
RETIREMENT READINESS RATIO IN CURRENT DOLLARS

RETIREMENT VARIABLE	CALCULATION
Percent of Pay to Retire "Well"	83%
Final Pay	$ 55,000
Final Pay to be Replaced (A)	$ 45,600
Social Security	$ 22,488
Account Balance as an Annuity	$ 20,196
Total Replacement (B)	$ 42,684
Retirement Readiness Ration (B)(A)	94%

Not bad, but not quite 100%.

Now, let's conduct a sensitivity analysis where we change five different variables by 20%:

1. Retiring 3 years early at age 64
2. Increasing the 7.11% rate of return by 20%
3. Increasing the 6.00% employee deferral by 20%
4. Increasing the employer match of 50% by 20%
5. Decreasing the 72 basis point fee by 20%

The question is: Which of the above variables do you think will have the greatest impact on the retirement readiness ratio for this individual? At FBi, we have analyzed this problem and publicly presented our findings since our first speech in 2009. We always ask people which item do they think will have the biggest impact and almost nobody picks the right answer, which is shown in Fig. 1.

So, there is no doubt that fees have to be reasonable. That is the law and that is what participants deserve. But as Fig. 1 shows, to examine fees without looking at value could really *hurt* participants in a most severe manner. For example, imagine a plan where the fees are really low but participants do any or all of the below:

> If you are a service provider and there is a "thing" that is "good" for both your plan sponsor clients and their participants, then it makes complete sense that you should care about that "thing." "

- They retire too early because they are not informed.
- They save too little because they are uninspired.
- They invest poorly because they are not properly guided.

A combination of these items would *far outweigh* the positive impact of a lower fee. To state the case more clearly using a "Captain Obvious" moment: "How can lower fees help someone not participating in the plan?"

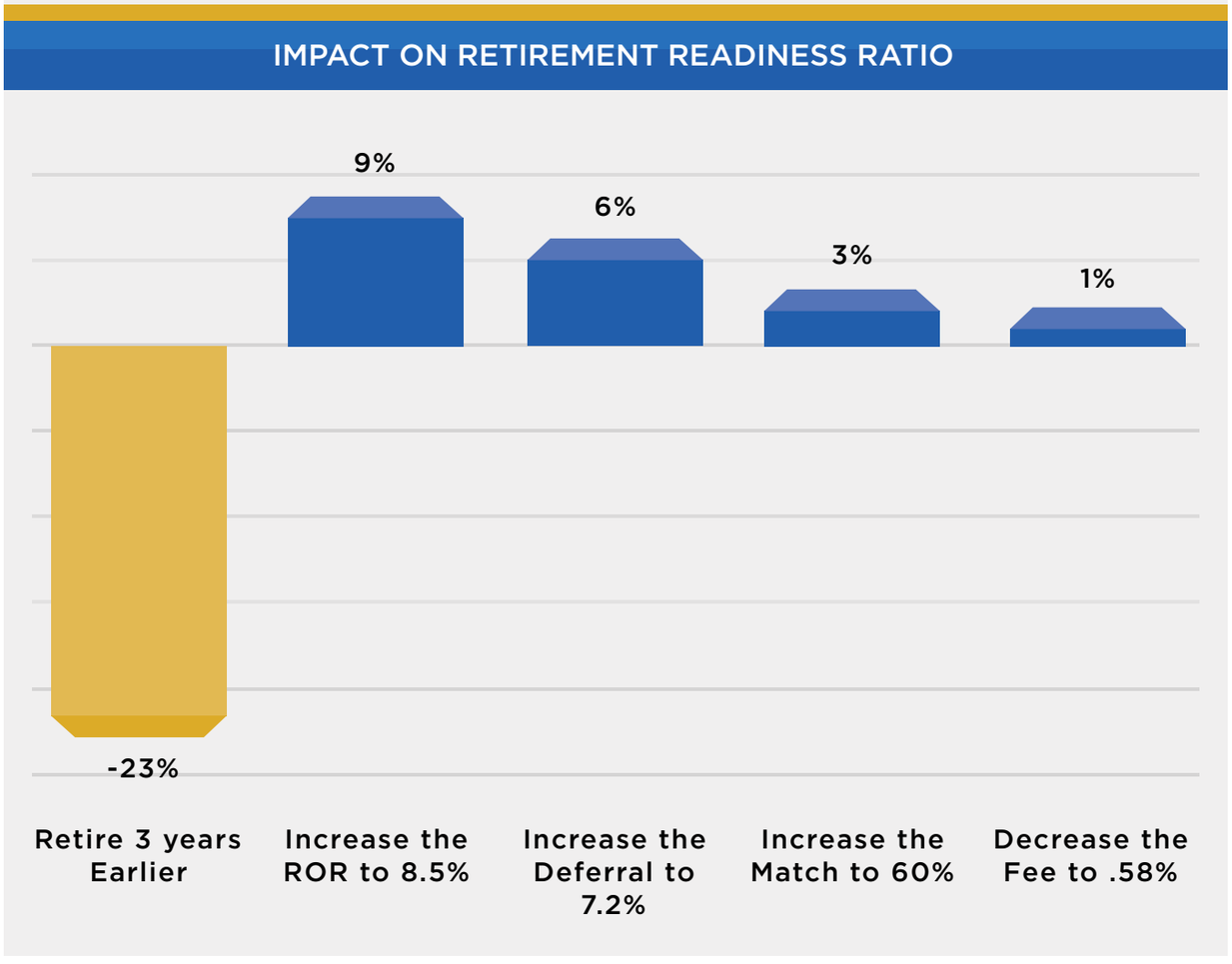
This is probably why the DOL notes the following in their "Handbook on 401(k) Plan Fees": *"Don't consider fees in a vacuum. They are only one part of the bigger picture including investment risk and returns and the extent and quality of services provided."*

So kudos to our industry for the intense focus on retirement outcomes. But let's make sure we understand which retirement variables truly drive such success and which others are of minor importance. To quote the great management guru Peter Drucker: "What gets measured, gets managed." Let's just make sure we are measuring the whole dog and not just the tail, because this is what participants deserve from our industry.

And that is the legal and social responsibility we assume as service providers on the behalf of millions of participants.

» Tom Kmak is the CEO of Fiduciary Benchmarks.

FIGURE 1



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Shea & McMurdie Financial
ShoeFitts Marketing
SLW Retirement Plan Advisors
Soltis Investment Advisors
Strategic Wealth Management
SunGard Wealth and Retirement Administration
T. Rowe Price
The 401k Coach Program
The Advisor Group
The Pacific Financial Group
The Standard
Thornburg Investment Management
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Transamerica
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Outcomes Are Not Everything; They Are the Only Thing

You can't tell who's winning without a scorecard.


BY ROCCO DIBRUNO AND TODD HARLOW

We are at an inflection point in the retirement industry. As an industry we have real challenges, but as a nation we have an even bigger challenge: enabling Americans to retire with dignity. The retirement savings crisis facing a majority of working Americans requires leadership from the financial advisor community, particularly the 401(k) plan advisor.

How many plan sponsors know, even roughly, the percentage of their employees who are on target to reach a clearly defined retirement goal? Clearly too few. That has to change if we are going to solve the nation's retirement savings crossroad.

For several years retirement plan advisors and service providers have concentrated on providing education and solutions to plan sponsors in the area of fiduciary responsibility. We are in the early stages of a movement toward improving participant outcomes. Since the 2008 financial crisis, numerous studies have detailed the retirement savings shortfalls of most Americans. For example, Bank of America Merrill Lynch's 2015 Workplace Benefits Report noted that 83% of all employers surveyed feel at least somewhat responsible for the financial wellness of their employees. As a result, employers are increasingly focused on participant awareness of financial planning for retirement and ultimately replacement income in retirement.

Today, most advisors and service providers are encouraging plan sponsors to add plan optimization features making easier for employees to enroll and save for retirement, including:

- improving outcomes involves with asset allocation models
- auto enrollment
- auto escalation
- auto re-enrollment

These will help improve participation and contribution rates. But a crucial component is still missing: documentation at the participant level for plan sponsors that the plan is working. Enter the retirement plan advisor of tomorrow.

A Google search for "broken 401(k)" will generate 5 million results. The Department of Labor, Congress and the press are playing the "blame game" for the retirement crisis. They blame everything from self-serving advisors and expensive investment products to inadequate plans, especially those of small- and mid-sized companies. Absent from the "blame game" is discussion of real solutions.

Advisers can change that. We have had 30 years for product-based solutions to generate success for the DC industry. Going forward, the success of the plan will flow through advisors who expand their plan consulting models to include workplace advisory services as part of the participant experience. In its 2013 Workplace Benefit Report, Bank of America Merrill Lynch reported that 70% of employers offered access to financial advisors and 80% believe that working with a financial advisor improves employees' retirement outlook.

> "How many plan sponsors know, even roughly, the percentage of their employees who are on target to reach a clearly defined retirement goal?"

Advisors who can deliver real, quantifiable solutions will not only be successful; they will be seen as leaders in the eyes of their clients. We experienced it during the last decade with the fiduciary movement. If you believe that plan success will ultimately be measured by outcomes, then it requires leadership and tenacity to deliver on the promise of sufficient and steady retirement income, enabling plan participants to retire with dignity.

It is time we embrace the advisor and highlight the advisory process at the plan sponsor and participant levels as the keys to success.

If we want to fix America's problem of unprepared retirees, we have to start by defining our objectives. That doesn't involve sundry and diffuse metrics such as participation rates, deferral percentages, account balances and asset allocation comparisons. Those have their place. But the most important measure is income replacement. The percentage of income replacement can and should be debated. This will undoubtedly define the benchmarking standards in the future and will likely differ by industry, plan size, and perhaps geography. However, we have to start keeping score on plans' success in providing income replacement.

Three aspects are involved:

1. **Accountability —** Find advisors willing to provide leadership to plan sponsors so together they can be accountable for improved participant income replacement.
2. **Documentation —** Rather straightforward, we need to measure participant income replacement. This will start with a before-and-after report addressing these questions: What percent of employees are on track for say 80% income replacement at the start of the engagement? What percent are now on track after one year? This needs to be an annual focus to reflect changes in market conditions, emotions of investors, and life events. The documentation format will spark debate, but the need for documentation isn't debatable.
3. **Investing Process —** Notice it is an *investing* process, not an *investment* process. The latter suggests a product focus. Investing suggests how one invests. The process of investing is both unique to the participant and it is portable for the participant, who can implement it amid changes of products and platforms over time.

The Investment Company Institute (ICI) notes that almost 80% of full-time workers have access to employer-sponsored plans. And, according to a Bureau of Labor Statistics (BLS) report from September 2014, the average job tenure in the private sector (as of January 2014) was 4.7 years for men and 4.5 years for women. If we assume a 40-year working life, the average American will have approximately eight employers in his or her lifetime. That implies roughly eight

> Absent from the 'blame game' is discussion of real solutions."

different 401(k) vendors; eight different investment menus; eight different employee communications policies; and eight different advisors. We shouldn't ignore the impact that changing jobs has on employees and their retirement accounts. We should, rather, guide the investing process that participants should employ over the course of their careers, helping them embrace the investment flexibility and engender a focus on future income liabilities.

"Income liability" is a term that is often associated with defined benefit pension plans. However, one could argue that any investment is a future "liability." Think about college education, future tax bills, endowment payouts, and yes, retirement income. Are they not all, in some way, future obligations or liabilities? Liability Driven Investing (LDI) is not new; it has been an investing process embraced by some of the most recognized and respected asset management pools in the world, including Harvard University, GE and the Rockefeller Foundation. If this process is right for them, why is it not right for the typical participant in a DC plan?

Figure 1 depicts a typical flow/description of an institutional LDI approach to investing. Figure 2 shows how that approach might be applied to individual goal-based investing.

The parallels between LDI and goal-based investment advisory are evident. This process should be scaled for implementation in the DC business. Plan participants should assess their progress annually, just as the established institutions do with their LDI. The review should incorporate market changes, life events and financial behavior. Participants will undoubtedly experience headwinds throughout an investing cycle. If we continue to solely focus on product enhancements or plan optimization features, we will ignore the changing dynamics and we will likely be in the same position, as an industry, 10 years from now.

To fix America's retirement crisis we need to agree on the objective and how to measure success. The advisor has to lead in the effort, documenting improvements in participant income replacement. We need to embrace an informed investing process for employees, who can use it in new jobs at companies with different DC products and platforms. This process will likely be implemented in a variety of ways:

- **Do it yourself** — participant goes to provider's website.
- **Your own advisor** — participant seeks advice from an investment professional.
- **"Go To Meeting" or webcast with advisor** — plan advisor helps participants implement proper investing process.
- **One-on-one meeting at workplace** — plan advisor implements proper investing process with participants.

Good advisors will drive the best results by incorporating a variety of methods and ensuring that participants review their accounts annually. The results should be tracked and credited to the leadership of the advisor.

How Can we Get Plan Sponsors to Embrace the Effort?

The fiduciary movement of the early 2000's defined the modern day fiduciary advisor as it relates to DC consulting — a prudent process for DC advisors and investment committees. The fiduciary movement highlighted the need for the creation of investment policy statements and fund monitoring, and eventually emphasized the evaluation of the reasonableness of DC plan fees. But the movement didn't take off until we tied legal liability to plan fiduciaries.

Fiduciary best practices should now include the measurement and documentation of participant income replacement. Plan sponsors and leading advisors obviously can't guarantee certain income replacement levels for participants. But the proposed fiduciary best practice would require fiduciaries to measure participant income replacement and document all methods attempted to drive improvement. It's time to start keeping score.

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FIGURE 1: INSTITUTIONAL LDI APPROACH

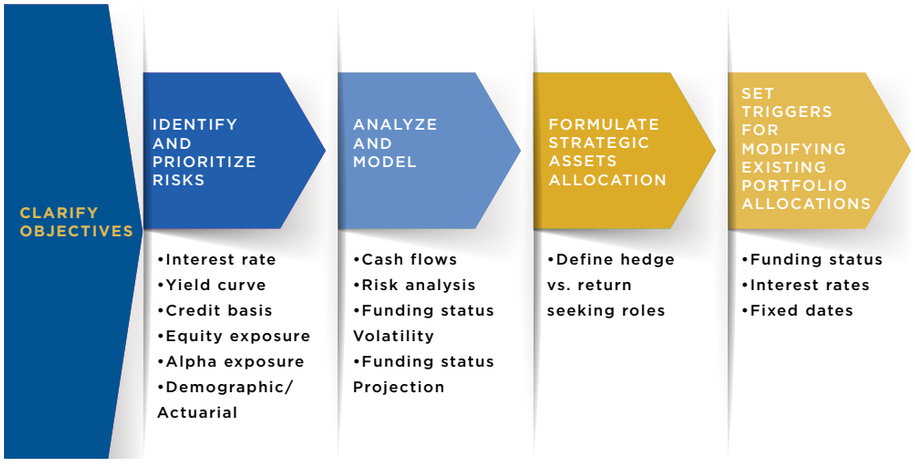
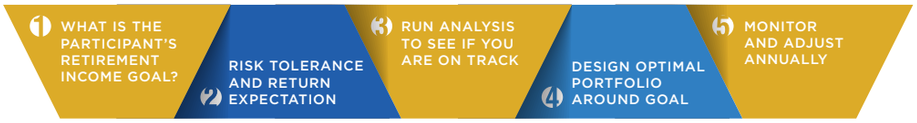


FIGURE 2: APPLYING IT TO INDIVIDUAL GOAL-BASED INVESTING



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Retirement Readiness Metrics: Revealing, Misleading or Both?

Data is nothing more than a collection of numbers, which can be interpreted in many ways.

BY JIM PHILLIPS AND
PATRICK MCGINN, CFA

At a retirement conference two years ago, the big buzz was about Big Data, and how it would revolutionize retirement plan management. The promise was that by having the ability to look at employee behavior in a very granular way, we could identify areas of need and target efforts accordingly.

Sometimes that works and sometimes it doesn't. People like magic bullets, but magic bullets don't always shoot straight. Data is nothing more than a collection of numbers, which can be interpreted in many ways. Knowledgeable interpretation can reveal valuable clues on where to direct efforts. Less knowledgeable interpretation can lead to misleading conclusions, and potentially move a plan further from its goals. A seasoned retirement plan advisor can be a knowledgeable interpreter.

Some of the challenges with "readiness metrics" include:

- There are no industry-standard readiness reports. They vary widely among providers, in both content and utility.
- Unscrubbed or incomplete data, from the employer or recordkeeper, can turn otherwise useful reports into junk.
- Readiness forecasts can be wildly inaccurate unless individuals volunteer information about other retirement assets they may hold (outside the workplace plan) or other retirement income streams they may be expecting.
- Reports provide "dots," but humans connect them, with greater or lesser skill.

Who Cares About Readiness, Anyway?

Good advisors care. They understand how to utilize success metrics to generate better employee outcomes, thereby demonstrating value. On the employer side, we have encountered a wide range of awareness and interest regarding readiness metrics and their potential value. Some employers might mistake the ADP test results as the only important "success metric" — pass the test, no one yells; fail the test, big shots yell. Part of our job, as an industry, is to make employers more success-centric. Many of them have never thought about how to define and measure "success" within the context of their retirement plan.

Often, employers offer a retirement plan because it's an expected part of the benefits package, and they haven't really thought much about its higher purpose. If prompted, most of them would have trouble disagreeing that the higher purpose of their retirement plan is to help employees achieve a dignified retirement. A successful plan is one that is effective to that end.

Beyond *doing the right thing*, there is emerging research to support the idea that getting employees on a path to retirement security actually makes good business sense. It can increase productivity, reduce turnover and allow older workers the option to exit the workplace earlier. Whatever their motivation, most employers would support the idea that it's better to have employees who aren't preoccupied with worry over their future.

> "People like magic bullets, but magic bullets don't always shoot straight."

Once Defined, It Can Be Measured

Simple, traditional success metrics, such as participation rate, deferral rate and investment diversification are widely available today, and serve as useful measurements of the current state of a plan. Competitive forces are pushing providers to offer increasingly sophisticated reporting, such as: breaking out the basic metrics by age, income level, and location; and diving deeper into the asset allocation piece (holding one fund is no longer automatically bad, if it's an asset allocation fund). This additional granularity can help the advisor to shape education campaigns and to focus platform resources such as targeted mailings.

The newest generation of *readiness* reports project future income replacement ratios. They take each participant's current balance, age, savings rate, assumed rate of return, and retirement age and project forward. Some add the ability for participants to include other retirement assets and retirement income streams and to fine-tune other inputs.

The system then projects the retirement income stream that would result, adds in the expected Social Security benefit and expresses the result as a percentage of pre-retirement income that would be replaced in retirement. Non-participating employees are factored into these reports using only their projected Social Security payments. The output shows what percentage of income the workforce is on track to replace in retirement. This can then be compared with a plan-level goal, such as 75%.

The income replacement analysis is much more sophisticated than the basic success metrics outlined earlier. But, does that mean it's necessarily better?

Let's argue this both ways:

- **Argument #1** — Forget the fancy colored reports. The goal is to enroll every possible employee, to get them to save as much as they can afford to, to get them into a risk-appropriate investment mix, and to help them to stick with this plan through thick and thin. I don't need any fancy metrics to accomplish this. Everyone deferring zero is a candidate for enrollment and can be easily targeted as such. If the plan offers a match, everyone saving below the match threshold can be targeted for a special reminder about the "free money" they are missing. Everyone else can be encouraged to escalate their savings rate annually or concurrent with a pay raise that may be forthcoming. It's better to *get people to do what they can* than to set unrealistic savings goals that may demoralize them right out of the plan. The investment education piece (get the right mix and stick with it) needs to be done in any event. Basic traditional metrics are enough for the advisor and the employer to keep the plan moving in the right direction.
- **Argument #2** — Bring on the fancy colored reports. If the goal is to replace income, let's focus on that. Without the knowledge of how much income the participants are on target to replace, we're flailing away in the dark. If they need to raise their saving rate, delay their retirement date or boost their rate of return, let's let them know that.

Which Argument Is Right?

It's hard to argue against the basic blocking and tackling advocated in the first argument. Why wouldn't you want to recruit every possible employee to participate? Why wouldn't you turn them upside down and shake all the possible coins from their pockets into a plan account? And, why wouldn't you want them in investment allocations that are risk-appropriate? All that makes sense.

On the other hand, why wouldn't you want specific data on how many of the employees are on target to replace a reasonable percentage of their preretirement income? If that's the goal, let's face the reality of where the plan stands. If readiness reports provide the level of granularity to identify individuals that are in need of work, that's really helpful.

However, some readiness reports are plan-level only. There are real problems potentially with judging a plan's success and allocating valuable resources based on macro readiness data. Figure 1 offers three examples to make this point.

> "Reports are tools. Tools can do serious work or serious damage, depending upon whose hands they are in."

Summing it up

Reports are tools. Tools can do serious work or serious damage, depending upon whose hands they are in. Seasoned advisors know how to use these tools to create better outcomes. Different plans come with different tools, so it is the advisor's job to analyze each situation using the most appropriate approach, applying common sense, behavioral finance lessons, capital market expectations, and knowledge of the unique character of each workplace.

Relying solely on the output of macro-level readiness reports can lead to a misdirection of important resources. We should push platforms to get as granular as possible in the metrics they provide. Action, based upon thoughtful analysis of detailed data, will lead to the best outcomes.

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» Vice President Patrick McGinn is a CFA charterholder and has been in the securities industry since 1993. He holds the Chartered Financial Analyst® designation, is an Accredited Investment Fiduciary, and is a member of the Boston Security Analyst Society.

The advisory team at Retirement Resources in Peabody, Mass., represented by Jim Phillips and Patrick McGinn, AIF, CFA, is the 2015 NAPA 401(k) Advisor Leadership Award winner.

FIGURE 1

Example 1

An organization with an older workforce is likely to score poorly in a plan-level readiness report. Many older workers didn't have access to good workplace retirement plans during their earlier years and consequently are behind their ideal glide path. The poor score might discourage an employer from allocating additional resources to a lost cause. This hurts the whole workforce, including any younger workers who would otherwise have had a good shot at a dignified retirement.

Example 2

An organization with a young workforce, with auto-enrollment at a reasonable level, would likely score highly in a macro readiness report. That's because younger workers enrolled into target date funds are going to look good on paper because of the possibility of 40 years of compound growth in equity-rich portfolios. An employer seeing that plan-level readiness report might declare victory and allocate resources elsewhere. But advisors with knowledge of behavioral finance understand the folly of the linear assumptions used. What happens when the market tanks and the equity-rich TDFs get creamed? Studies suggest that Millennials are risk-adverse. It's likely that many will bail out *after* they take their first big hit, and perhaps not get back in. When that happens, the great macro score will disintegrate.

Example 3

An organization with a large percentage of low-wage employees may look misleadingly good on a readiness report, because of the assumption that Social Security will replace a high percentage of their income. Declaring victory and moving on will set these people up for potentially tremendous disappointment in the future if the projected Social Security benefit isn't there. It would be much better to follow the traditional approach of recruiting as many of them as possible into the plan and encouraging them to save as much as they can afford to. We can all agree that there is no such thing as having too much retirement saving.

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