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Retirement Program Designs of the Future: Beyond Automatic Plan Features

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As retirement plan sponsors focus on increasing retirement income replacement ratios for participants and new generations enter the workforce, they need to look at enhancing their retirement programs so participant retirement goals are met.

As it became clear that defined contribution (DC) plan participants were struggling with savings and investing decisions, the use of automatic plan features, encouraged by the Pension Protection Act (PPA), became the new trend in helping participants reach their retirement goals.

The 2017 PLANSPOSOR DC survey found that 42.7% of DC plans overall use automatic enrollment, and 35.4% use automatic deferral escalation. This increases to 65.6% and 67.3%, respectively, for the largest plans. In addition, many DC plans are defaulting participants into target-date funds (TDFs) as a set-it-and-forget-it investment strategy—letting professional managers take control of investment diversification decisions.

However, as retirement plan sponsors focus on increasing retirement income replacement ratios for participants and new generations enter the workforce, they need to look at enhancing their retirement programs so participant retirement goals are met.

"'Set-it-and-forget-it' might be the approach that many participants prefer to take when it comes to their retirement plan account, but for employers such an approach can be extremely limiting—or even detrimental. As with most components of a successful business, staying up-to-date on new developments as a means of remaining competitive can make a huge difference," says Chuck Coldwell, vice president – national director, consulting and BOLI Services at Pentegra, who is based in Katonah, New York.

Coldwell believes as an industry, we still have not reached the goal of getting the majority of participants in a good place for retirement—even with auto enroll and escalate, there is a long way to go to get the majority of participants into these types of plan design. "DC plans are not first on people's minds. Getting them to save what they need to is still a huge challenge. Automated features will help without a doubt to build better account balances, but employees still have responsibilities for decisions about how much to save and how to invest," he says.

Joel Lieb, director of SEI Defined Contribution Advisory in Oaks, Pennsylvania, adds that meeting the needs of younger and new generation participants is especially important. "The simple truth of the matter is that younger folks do not have the same set of resources as older employees, who have generated real and sustainable retirement income through pension plans. Younger workers, we all know, are having to rely almost exclusively on defined contribution plans, and that will be the case moving forward," he says. "I mention this well-known background because today we are stepping back and asking, what can we do to help plan sponsors make their defined contribution plans just as effective at creating retirement wealth as have been DB [defined benefit] plans? How can we help employees get into a position where they can retire when they want to, and not be forced into the situation of trying to work past the traditional retirement age, because of poor planning?"

Targeted communications and financial wellness

Coldwell says he is a firm believer in education. "Education has to be more than in-person because that can't happen as frequently as needed. We push out education rather than waiting for participants to seek it. There is still a challenge of making sure they read it, but I still think it is the best method, and it has to be consistent.

An Insights article from Sibson Consulting states that, "A pivotal factor in helping employees improve their retirement readiness is opening the channels of communication and customizing the messages. To have a meaningful impact, plan-related communication must be actionable and personalized. Except in rare instances, one-size-fits-all is a misnomer; it should be one-size-fits-few. Communication should also be easy to understand and delivered on a regular basis, beginning well before retirement age. Further, the impact of the communication must be measurable, so the results can be monitored."

Doron Scharf, senior vice president with Sibson Consulting in New York City, says one of things Sibson does is a survey to find out what drives behaviors of participants. This helps with targeted communications. Jonathan Price, Sibson Consulting vice president and consultant in New York City, adds that communications should be provided about the retirement plan, but capturing participant behaviors and intentions—understanding them—will apply to not only retirement plan communications, but overall financial wellness education.

For younger workers, one way to make these conversation more concrete is to use the framework of "Health, Education and Retirement," says Lieb—a concept explored in an SEI paper, "The Next Generation of Retirement Plan Participants." Lieb adds, "We know that younger employees, as they get their foot in the door, they face significant student debt burdens and they have to make decisions about starting a family and other challenging topics. We think that DC plan sponsors are in a great position to help these people, especially as we see technology improve and it becomes easier to link all the necessary infrastructure that will help folks both see and manage their holistic financial picture."

Robb Muse, senior vice president of SEI Trust Company in Oaks, Pennsylvania, says, "One of the chief challenges that we face today as providers and sponsors is that we don't exactly have a complete picture of individual plan participants. Where the industry is moving, slowly but surely, is towards finding a way to put together a solution that offers a holistic view of the participant lifecycle. Having this visibility will help us better understand how participants evolve, from the time they start with the company to the time they retire. Early on in the savings journey, for example, we know it is more important to look at the debt and other financial burdens the employee is carrying, and analyzing how these factors impact decisions in terms of investing in the plan. As we build a more holistic view of the employee, as the employee ages and the needs evolve, the plan sponsor can help them shift priorities. That's the kind of evolution we are trying to push forward—building a full picture of what individuals' life needs are and how we can address them going forward."

Scharf says employers should convey that the retirement plan is only part of the broad financial wellness of participants. Remind them how important retirement savings is, but address other needs.

Coldwell says tools are also important for educating retirement plan participants. Employers should provide tools for employees, such as calculators, differentiators between Roth and pre-tax (he says the average participant doesn't understand the benefits of Roth deferrals) and investment concepts. He notes that the Advice Plus software program from Pentegra tells people if they are falling short of retirement goals; they may have to save more but may have to reinvest. And, it actually tells participants what funds to use in their portfolios.

Plan design changes

Sharf says one step beyond automatic enrollment and automatic escalation is automatic re-enrollment. Facing the behavioral concept of participant inertia, making employees choose to opt-out every year increases the opportunity to engage them. In addition to helping employees save at the default deferral rate, re-enrollment can help participants with investment decisions, as they are re-enrolled periodically into a default investment strategy such as TDFs, Coldwell adds.

Robb Muse, senior vice president of SEI Trust Company in Oaks, Pennsylvania, says he pulled data from two plans in which the firm has had great success getting people into the qualified default investment alternatives (QDIAs), and in both of those plans less than 5% of participants did any type of trading in response to recent market drops. "In fact in the one plan, which has something like 80% usage of TDFs, that plan population had less than 1% of active participants do any trading during the month. Another plan that has about 50% of

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assets in TDFs; they saw less than 4% of participants make trades during February. Looking at those in TDFs solely, the figure drops to 2%," he notes.

Sibson also suggests DC plan sponsors stretch their match formulas. Jonathan Price, Sibson Consulting vice president and consultant in New York City, suggests that if a plan auto enrolls participants at 6% and matches 100% of 6%, but auto escalates participants to 10%, the plan sponsor may consider stretching the match to 60% of 10% of deferrals to incentivize employees to stay with auto escalation. Doran notes that this does not cost plan sponsors anything additional.

However, Price warns that when considering implementing a stretch match, plan sponsors should consider examining whether a portion of the participant population feels they cannot afford to increase deferrals. In this case, stretching the match could be disenfranchising to employees and could have unintended consequences.

Sibson also suggests DC plan sponsors should consider participants transition from accumulating account balances to generating income. According to the Insights paper, "Offering income options (e.g., lifetime annuities, qualifying longevity annuity contracts (QLACs)), either within or outside of the organization's retirement plan, can help employees feel comfortable that they will be able to retire when they want."

In addition to stretching the match and re-enrollment, Pentegra suggests allowing rollovers in plans and ending automatic cash-outs. "Why leave money in a 401(k) account from a previous job—or withdraw it and deal with penalties and taxes—when you can just add it to your current retirement savings vehicle?" Coldwell queries.

He adds that instead of automatic cash-outs, plan sponsors should use automatic rollovers. "Cashed out money is likely to spent on something other than retirement," Coldwell says. "I understand the need to clean up records and decrease costs, but rather than give money to participants, set up an IRA for them, and in communications, when someone terminates employment, remind them they still have a balance and can possibly roll it over into a new plan or IRA."

Simplify investments

Muse says helping participants with streamlining and simplifying their investment menus is important, and a big part of this is ensuring investors are routed into age-appropriate and well-diversified QDIAs. However, many participants favor the ability to take a hands-on approach to investing. But, according to SEI's article, "What these individuals prefer to do without is the research and due diligence of the [many] investment options available on their plan's menu."

Muse says helping these individuals build a custom investment portfolio generally involves going down the white label route and exploring the use of collective investment trusts (CITs). He explains that CITs are attractive investment vehicles to use within retirement plans for a variety of reasons. In addition to the cost and pricing benefits associated with CITs, the customized packaging capabilities allow for smoother administration of plan investment lineups, participant communication and plan-specific branding. Likewise, the construction of portfolios as CITs permits the inclusion of smaller, niche managers who may not offer a mutual fund product lineup, which can be especially beneficial in emerging areas, such as environmental, social and governance (ESG) and other socially responsible investments.

SEI explains that white-labeled investments are funds that include several different fund managers within a certain investment strategy. For example, participants can be presented with one Multi-Manager U.S. Large Cap Equity Fund, but it consists of five different types of large-cap equity funds—simplifying the large-cap fund choice for DC plan participants.

Muse says a further spin on this method of menu creation is to take a goals-based approach, where rather than presenting participants with investment options labeled as broad asset classes, goals such as growth, income and stability are highlighted. "Though this type of plan menu design strategy hasn't gained traction yet in the marketplace, the potential benefits in terms of participant engagement and outcomes are significant," he says.

"Plan sponsors must understand that they still have a responsibility to their work force to help them plan for retirement in a realistic way," Lieb concludes.

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