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Plan Sponsor Survey 2012: Action Needed to Drive Better Participant Outcomes

By Lori Lucas, Callan Associates and Catherine Peterson, J.P. Morgan Asset Management

Survey results hightlights

Over the past two years, DC plan sponsors have taken small but significant steps to help participants improve their readiness for retirement, according to the Defined Contribution Institutional Investment Association's (DCIIA's) 2012 Plan Sponsor Survey. DCIIA's second Plan Sponsor Survey also found opportunities for plan sponsors to build on their progress, especially by taking greater advantage of automatic plan features.

Chief among the survey's findings: Plan sponsors know what they need to do, but are hesitant to do it.

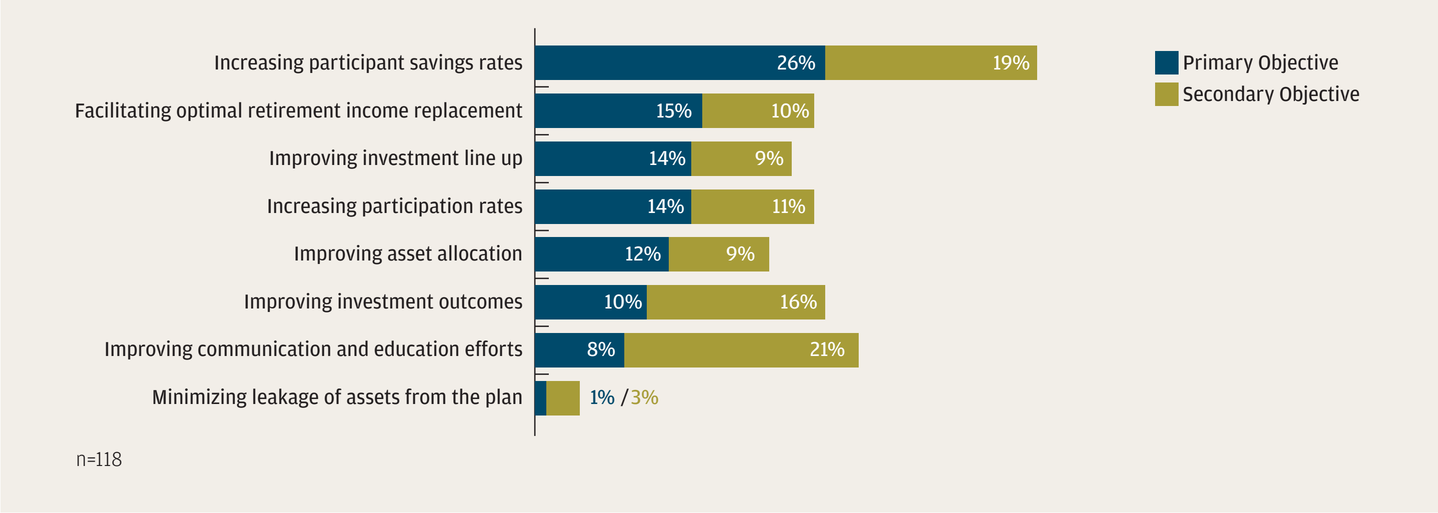
Plan sponsors know what's needed

When asked about their top objectives, nearly half of plan sponsors put "increasing participants' savings rates" first or second on their priority list. This is encouraging: One of DCIIA's core beliefs is that boosting savings rates offers one of the greatest opportunities to improve participant outcomes. In the words of one large DC plan sponsor, "We want to optimize participant income replacement, and one of the major ways to do that is to increase contribution rates. With fewer DB plans around, the emphasis on increasing contributions seems appropriate to me."

Plan sponsors' other major goals also aligned with DCIIA's beliefs. They included:

- improving communication and education efforts
- improving investment outcomes
- facilitating optimal retirement income replacement
- increasing participation rates

Primary plan objectives



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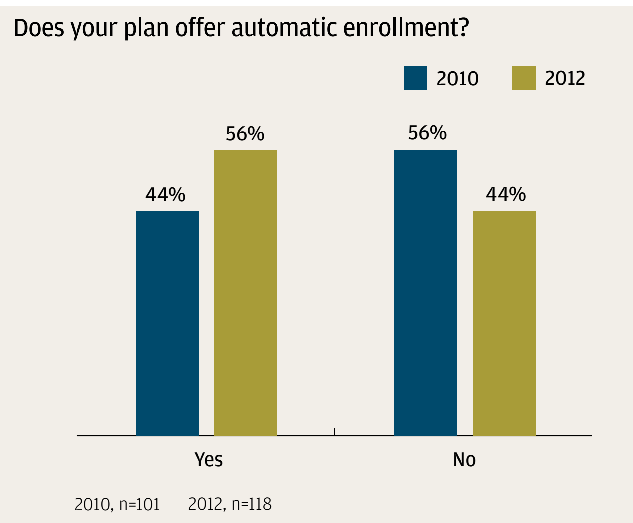
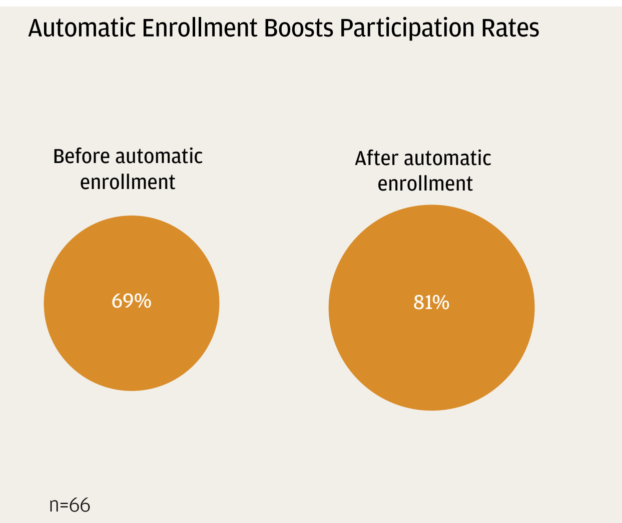
Automatic enrollment picking up steam

The survey findings highlighted the increasing use of automatic enrollment. Some 56% of plan sponsors surveyed use this feature, up from 44% in 2010, and the trend is gaining momentum: A third of plan sponsors that don't currently use automatic enrollment expect to add it within the next 12 months, almost double the percentage in 2010. Enrolling participants automatically makes a major difference in participation: Plans that added automatic enrollment increased their participation rates by 12 percentage points, to 81%.

The plan sponsor we spoke with encourages new hires to sign up for the plan during orientation, then uses auto-enrollment to pull in those who don't. "Our preference is for people to make an affirmative decision to enroll," he says. "But if they don't—maybe because they're overwhelmed during orientation, or unsure of what to do—we can use auto-enrollment as a backstop."





Yet a subset of plan sponsors continues to steer clear of automatic enrollment. Among the 44% of plan sponsors that don't currently make use of the feature, almost half say they are very unlikely to add it in the next 12 months. That figure has fallen significantly: In 2010, some two-thirds of plan sponsors without the feature said they were very unlikely to add it in the following year. Still, resistance in this niche remains surprisingly high. Among the most common reasons for not adding automatic enrollment: the sense that participation rates were already high enough (27%) and a belief that automatic enrollment is too paternalistic (19%).

Default savings rates fall short

Unfortunately, the way plan sponsors have implemented automatic enrollment may actually undermine their number-one goal of increasing savings rates.

Most plan sponsors say participants should set aside at least 10% of their income. Yet plans with automatic enrollment generally set default contribution rates very low, with more than half reporting default contribution rates of 3% or less. Multiple studies show that auto-enrolled participants tend to stay at their default contribution rates, perhaps due to inertia or because participants take the default as a tacit endorsement of the low rate.

Some companies have increased their default contribution rates, which is a good sign of progress. But 54% continue to start auto-enrolled participants at a rate of 1%, 2% or 3%, leaving considerable room for improvement.

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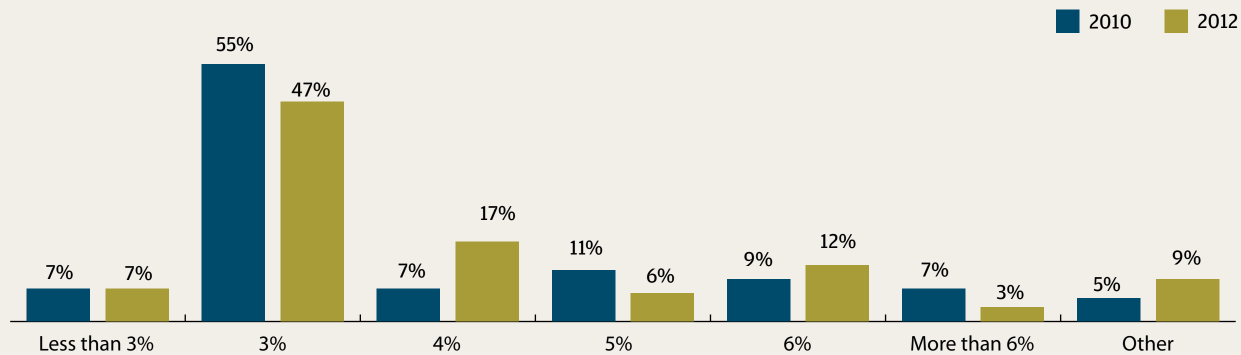
Automatic enrollment default contribution rates



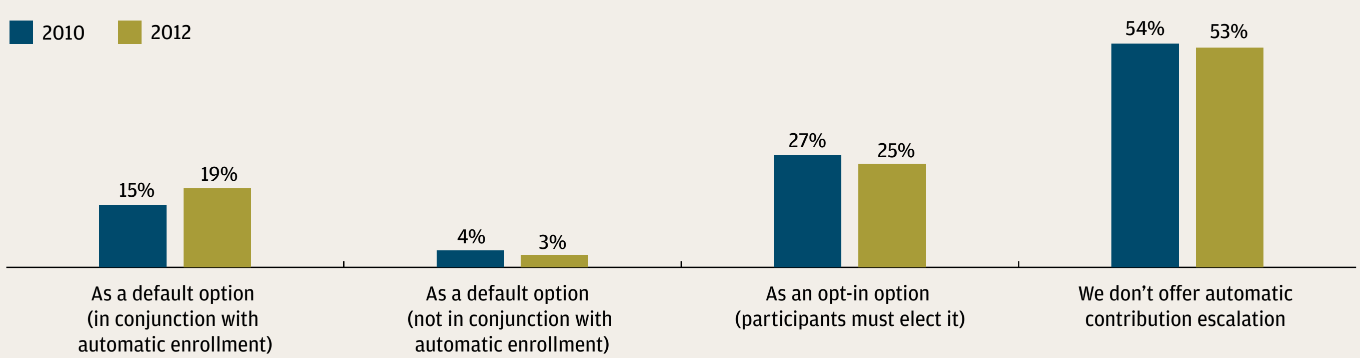
2010, n=44 2012, n=66

Companies may be concerned that raising default contribution rates would cause greater numbers of participants to opt out of the plan. Several studies suggest that this isn't the case—that plans could boost default contribution rates significantly without a meaningful increase in opt-outs. "We have a default rate of 6%, and that maximizes the company match," a plan sponsor notes. "It's an attractive enough program that it's pretty unusual for people to opt out."

Still, plan sponsors may be concerned that their specific population of workers might react negatively to higher default contribution rates. In that case, they can consider auto-enrolling participants at lower default rates, and then using automatic contribution escalation to boost savings rates over time. Automatic contribution escalation may be the most powerful tool plan sponsors have to help participants save more. Of the plans that offer this combination, half saw it as a way to prevent participant inertia from derailing retirement savings, while almost all believed it could help participants achieve their retirement goals.

Yet the 2012 Plan Sponsor Survey found that only a small fraction of plans use automatic enrollment in conjunction with automatic contribution escalation. What's more, the percentage of plans offering automatic contribution escalation has not increased significantly in the past two years—one of the biggest surprises uncovered by the survey.

How plans offer automatic contribution escalation



2010, n=101 2012, n=118

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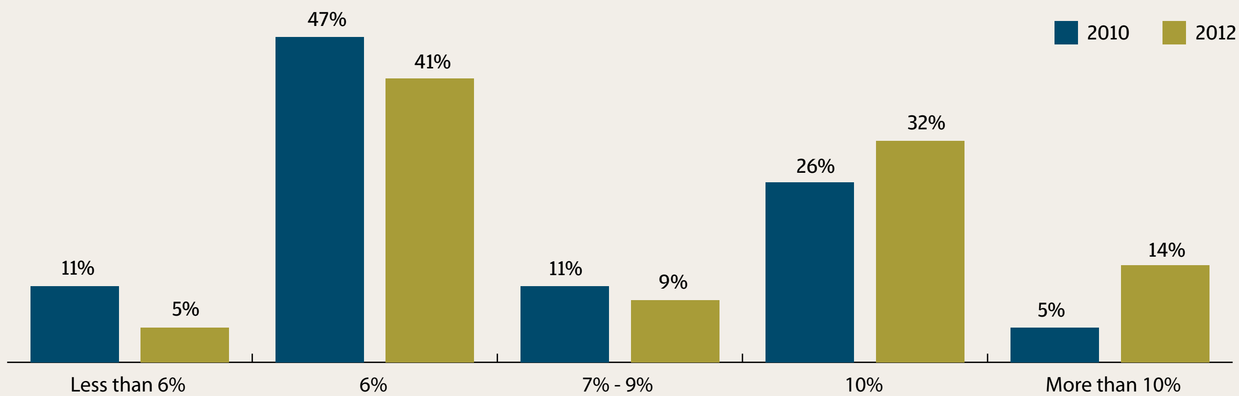
Plan decision makers may be skittish about pushing participants to save more, given the state of the economy. But if they truly want to encourage higher savings rates, they should give automatic contribution escalation serious consideration. "I don't know why more plans don't do this, particularly if they're starting people at 3%," says the administrator of a large plan. "All the data suggest that people aren't going to get to the contribution rate they need on their own."

The survey revealed that some plan sponsors are considering adding automatic contribution escalation: 14% of plans that do not currently offer the feature expect to add it in the next year. And larger plans are more likely to adopt it than smaller plans, so the move stands to affect a relatively large number of workers.

Plans with automatic contribution escalation ramping it up

In a positive trend, this year's survey found that plans with automatic contribution escalation seem to be using it more aggressively. Many plans that use this tool have increased the cap on the contribution rate, with almost half placing the cap at 10% or higher, up from a third in 2010. (Note: Plans that want to qualify for the non-discrimination testing safe harbor cannot have automatic contribution escalation caps higher than 10%.)

Where do plans cap automatic contribution escalation rates?



2010, n=19 2012, n=26

Early adopters likely started small, with relatively low ceilings on rates. But they may have decided to take greater advantage of automatic contribution escalation after discovering that most participants embraced the program. After all, participants have responded favorably: More than two-thirds of plans with automatic contribution escalation have opt-out rates lower than 10%, and half have opt-out rates of less than 5%.

In fact, plan sponsors say that their participants' attitudes toward automatic contribution escalation have improved: In 2010, a little more than a third of plans thought their employees had a somewhat or very favorable response to automatic contribution escalation, compared to more than half today.

While plans with automatic contribution escalation appear to be embracing it more vigorously, they could go farther. In particular, the vast majority of automatic contribution escalation programs increase contribution rates by only one percentage point per year. A larger annual increase would move participants' to higher contribution rates more quickly.

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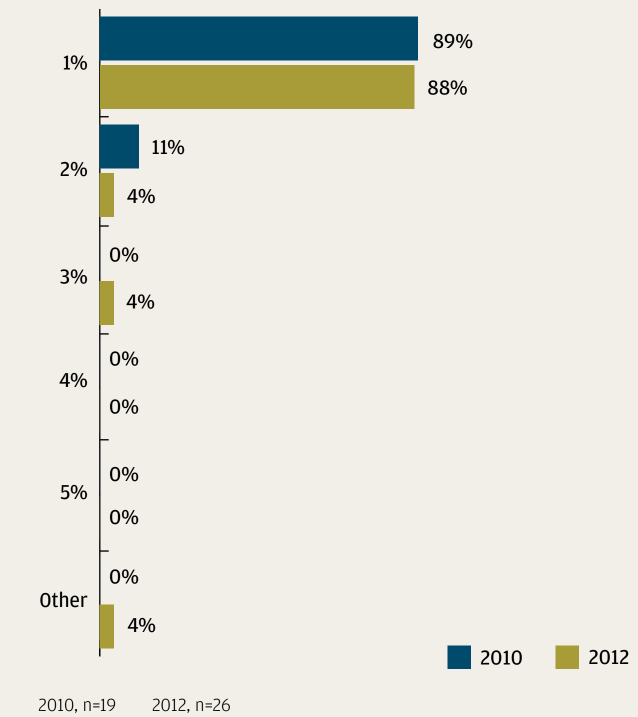
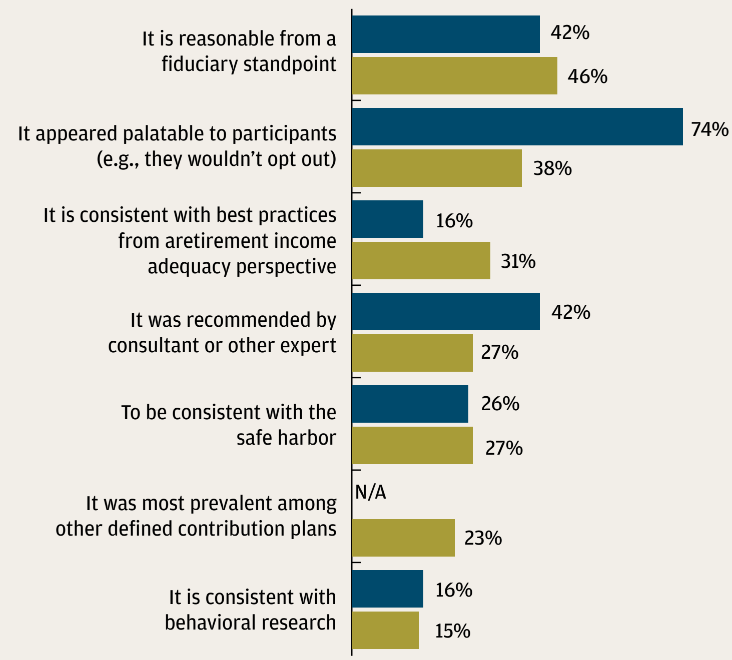
Automatic contribution escalation rates still low



Reasons for choosing contribution increase rate



Plan sponsors who don't currently offer automatic contribution escalation can learn from the experience of early adopters. These companies' increasingly aggressive use of the feature suggests it is working for them and they want to take greater advantage of it. Plans new to automatic contribution escalation may want to follow these firms' lead and start with a cap higher than 10%, and should consider annual increases of two percentage points.

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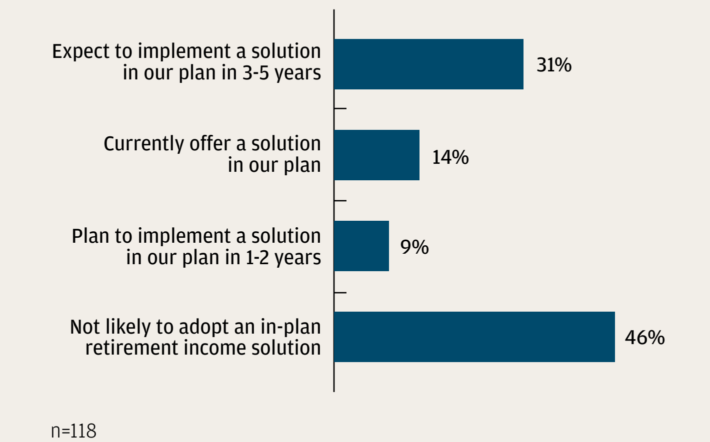
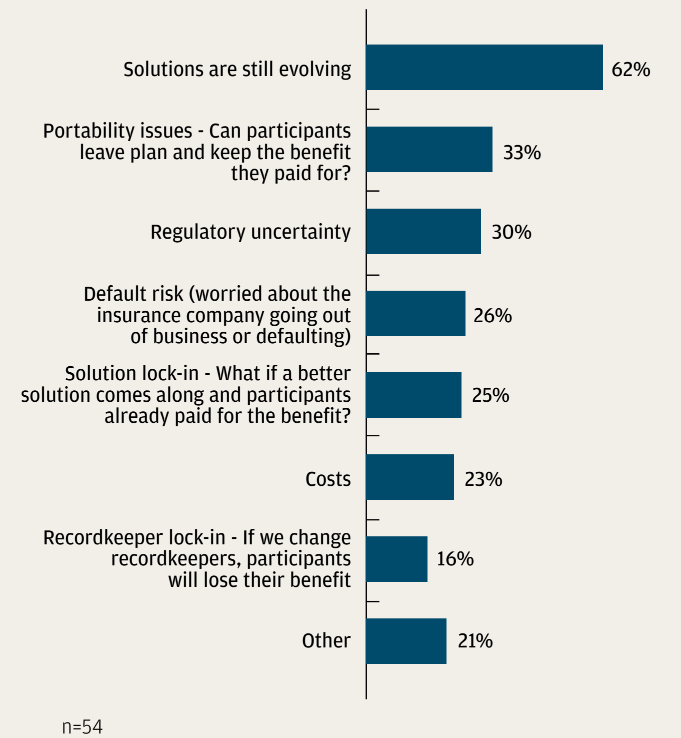
Exploring retirement income solutions

Retirement income solutions remain rare among plans of all sizes, with only 14% currently offering them. However, 40% say they expect to implement a retirement income solution within the next five years. Plans say they haven't yet offered them because solutions continue to evolve, and also due to concerns about portability and regulatory uncertainty.

Likelihood of offering retirement income solution



Reasons for not offering retirement income solution



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Detailed findings

The current study builds on the first Plan Sponsor Survey, conducted in 2010. It represents the latest installment in an ongoing effort to understand trends in the DC industry and improve plan design.

DCIIA sought insight into the ways larger plan sponsors view automatic features in DC plans. We wanted to understand the factors that drive plan sponsors to adopt automatic features, the ways they design the features and the changes they plan for the future. We also sought to capture plan sponsors' thoughts about increasing participant saving rates—one of the most important challenges across the DC industry.

Respondent breakdown

A total of 118 plan sponsors completed the survey between March 1 and April 6, 2012, with representation from all large plan market segments. The following table presents the breakdown by plan size. This survey included more plans in the smallest segment than the 2010 survey did, but that shift played no part in the majority of trends reported in the current survey. The current year's survey also represents a larger sample size than in 2010, which included responses from 101 plan sponsors.

There was equal representation from human resources/benefits respondents (42%) as from treasury/finance respondents (42%). The remaining 16% were from other parts of their companies, including investments, executive committees, partners and management.

Fig 1. Respondents by plan size

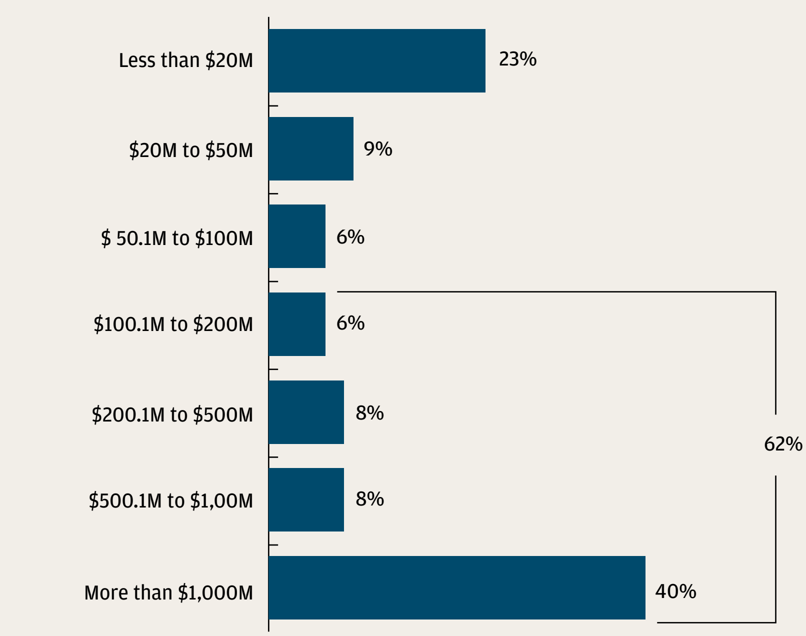
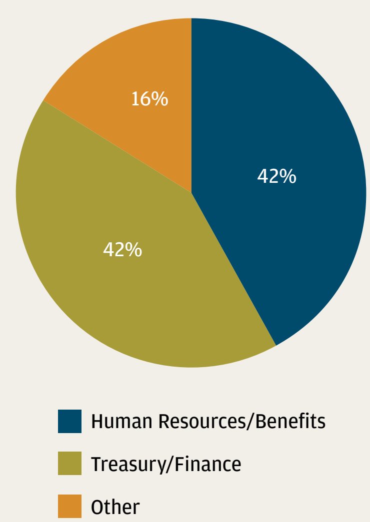


Fig. 2 Respondents by department



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Defined benefit plan influence

Of the survey respondents, 27% offer an open defined benefit (DB) plan with traditional design, down from 35% in 2010. Fewer companies (16%) offer a cash balance plan, but this figure doubled since 2010. The percentage of respondents with a frozen defined benefit plan was effectively flat (21% versus 20%) and 28% of respondents don't offer a DB plan.

With roughly half of plan sponsors no longer offering an open DB plan, more are likely to take a paternalistic approach toward their DC plans. A third of plan sponsors with a DB plan indicate that their DB plan does not influence the structure of their DC plan, while 18% state that they leverage existing investment manager relationships. Some respondents adjust their employer contribution level in their DC plan based on their DB plan, with 16% offering lower employer contributions in their DC plan and 14% offering higher contributions.

It is interesting to note that 7% of respondents include higher-risk investments in their DC plan due to the presence of a DB plan, while 6% offer lower-risk investments. This split reflects the lack of consensus about the impact of a DB plan on participant needs: Whereas some plan sponsors believe the guaranteed income from a DB plan frees participants to pursue greater risk with other assets, others note that a DB plan reduces participants' need to take on risk to maintain their standard of living in retirement.

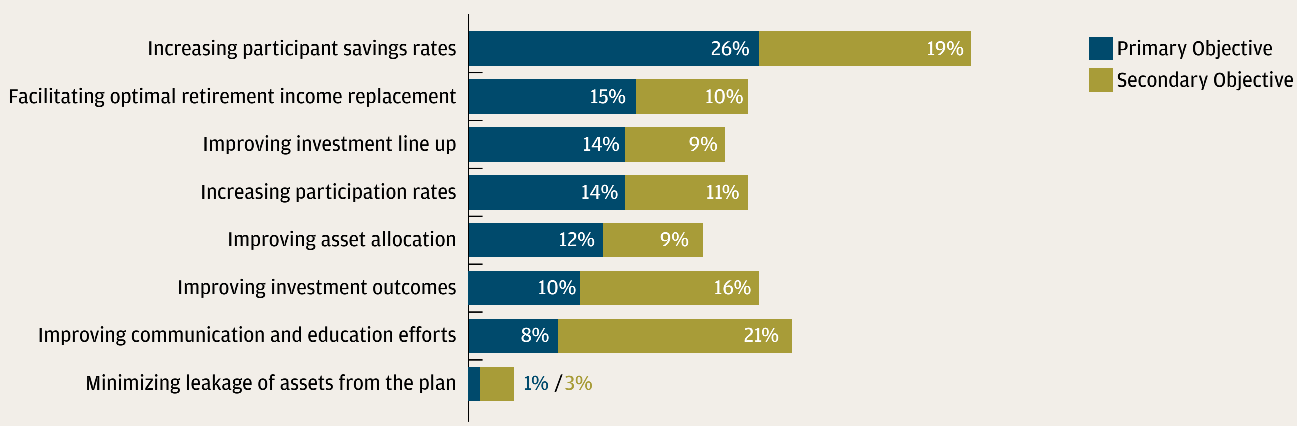
Primary objectives of plans

Increasing participants' savings rates was the first or second objective listed by nearly half (45%) of survey respondents—by far the most frequently listed goal. We are encouraged by this finding, because DCIIA believes that increasing savings rates offers a major opportunity to improve participant outcomes. Plan sponsors also acknowledged the importance of:

- improving communication and education efforts (29%)
- improving investment outcomes (26%)
- facilitating optimal retirement income replacement (25%)

Less common objectives included improving the investment lineup (23%), improving asset allocation (21%) and minimizing leakage of assets from the plan (4%).

Fig. 3 Primary plan objectives



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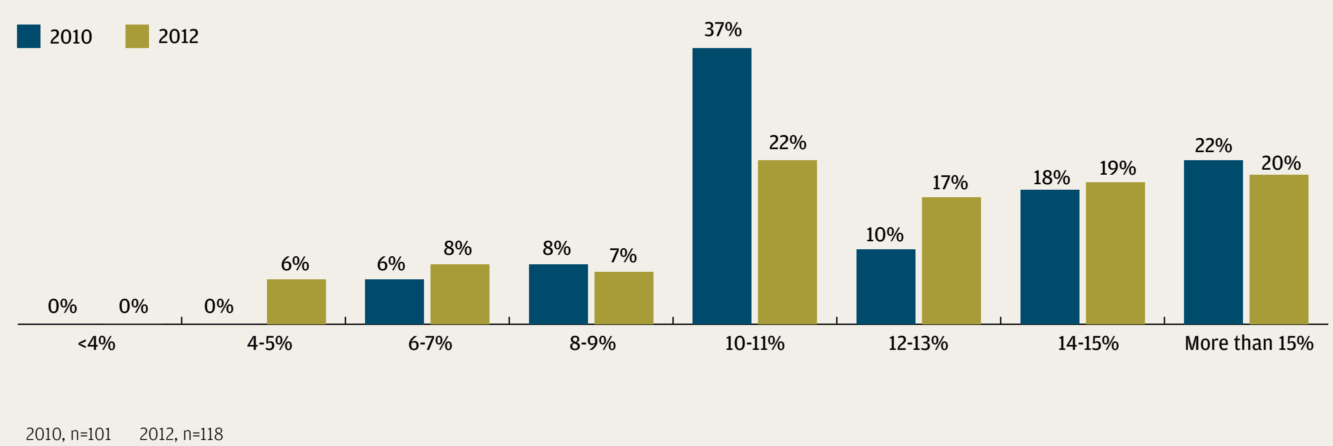
Optimal savings rates

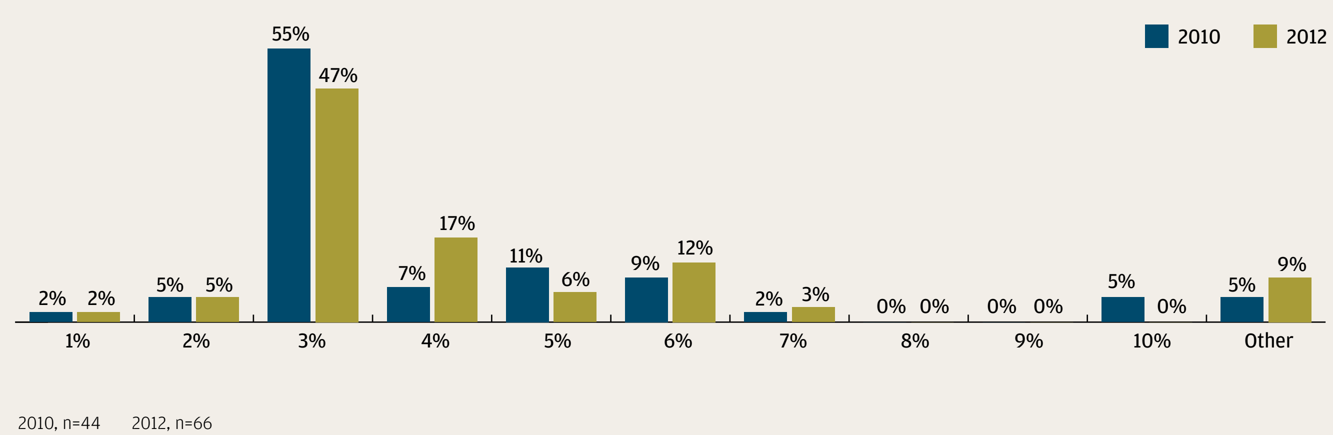
A majority of plan sponsors (78%) said the optimal savings rate was 10% or more, and 20% cited an optimal savings rate of 15% or more. Interestingly, the percentage of respondents citing a double-digit savings rate as ideal fell nine percentage points from 2010.

Fig. 4 Optimal savings rates according to plan sponsors



While plan sponsors generally say high savings rates are optimal, they set default contribution rates very low: Nearly half (47%) of plans with automatic enrollment have a default contribution rate of 3%. This number has fallen from the 55% of plan sponsors who said in 2010 that they set their default contribution rates at 3%, and in that respect represents a move in the right direction—especially considering that there has been no increase in the percentage of plans using 1% or 2% as a default contribution rate. Still, there remains a wide gap between the most common default contribution rate and the contribution rate that plan sponsors generally agree is optimal for savers.

Fig. 5 Current default contribution rate for automatic enrollment



The continued presence of this gap seems at odds with the fact that 40% of respondents identified an increased sense of urgency to boost participant savings rates. In the words of one respondent, “The company’s 401(k) is now the primary source for retirement benefits. After careful review we find the participants are not contributing enough to reach retirement security.”

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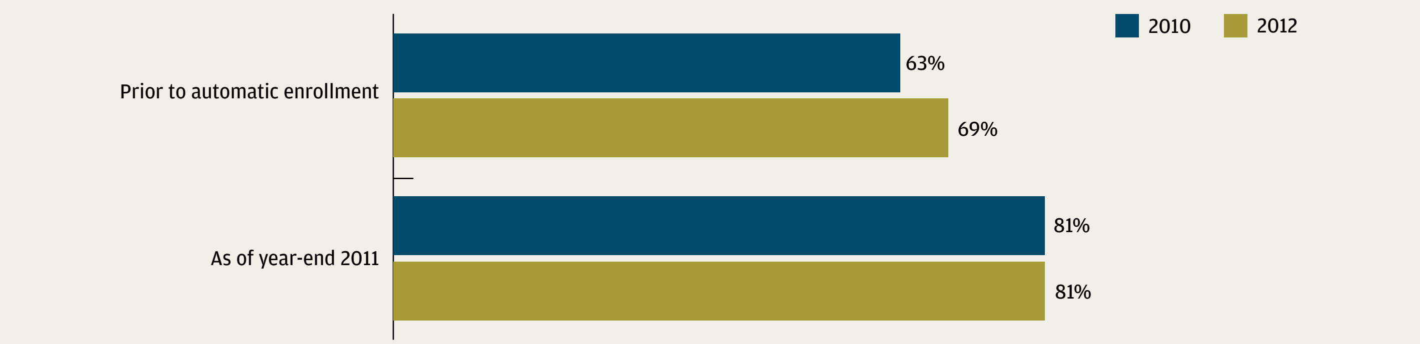
Automatic enrollment

The percentage of plans offering automatic enrollment increased markedly. It now stands at 56%, up from 44% in 2010. Nearly three-quarters (73%) of plans with automatic enrollment use target date funds as their QDIAs, up marginally from the 70% figure in 2010. And nearly a third of plan sponsors that do not currently offer automatic enrollment say they are likely to add it in the next 12 months, compared to just 16% of plan sponsors who said the same in 2010. This trend bodes well for participation rates, given that plans that have adopted automatic enrollment saw participation rise from an average of 69% to an average of 81%.

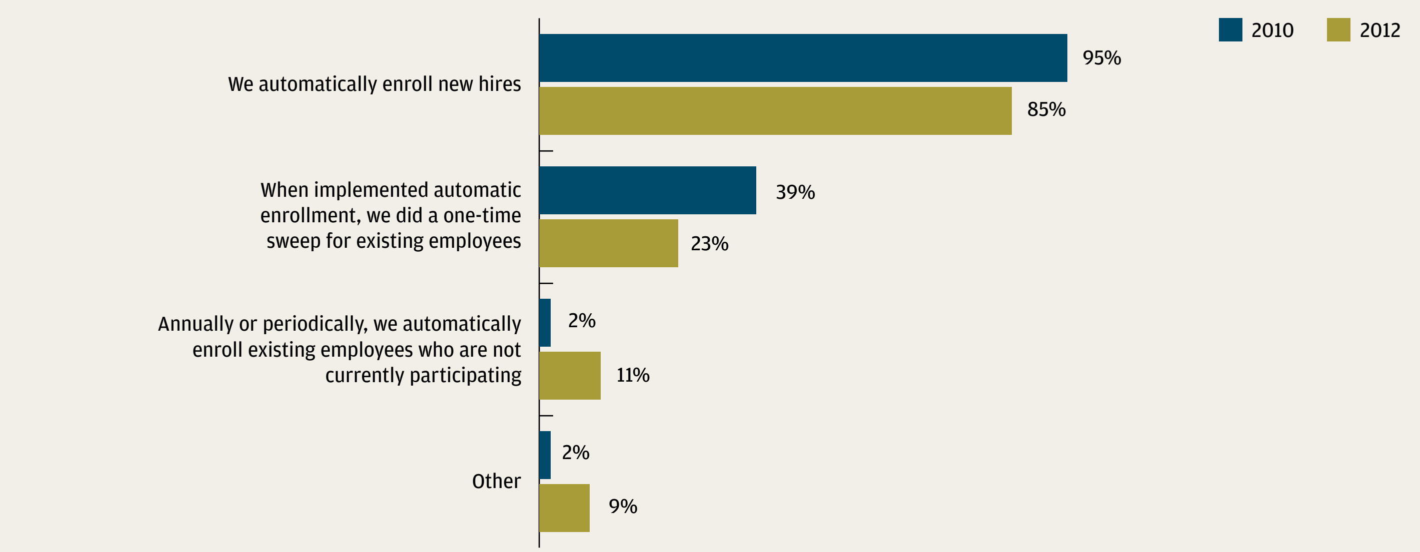
Fig. 6 Participation rates before and after automatic enrollment was implemented



2010, n=44 2012, n=66

Some 85% of companies automatically enroll new hires, but the majority apply automatic enrollment only to this group—potentially representing a missed opportunity. In a positive sign, the percentage of companies automatically enrolling non-participating employees on an annual or periodic basis rose from 4% in 2010 to 11% in 2012.

Fig. 7 Ways plan sponsors automatically enroll participants



2010, n=44 2012, n=66

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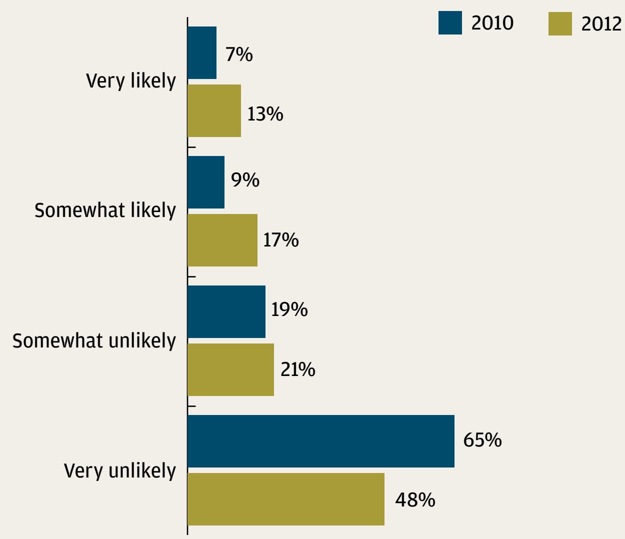
The vast majority of respondents (69%) have no plans to change the structure of their automatic enrollment programs, and only 8% of respondents reported that they would increase their default contribution rate going forward. We hope to see large improvements in this figure in our next survey.

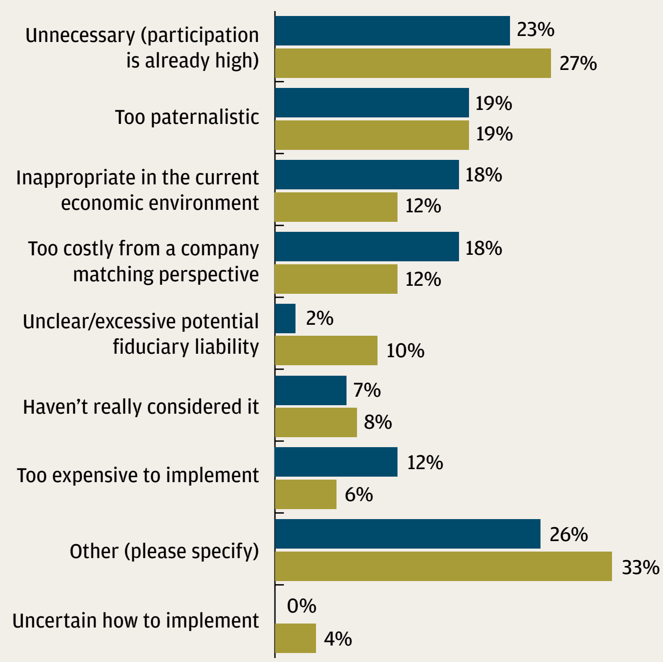
The survey also asked plan sponsors that don't use automatic enrollment their reasons for not taking advantage of it. Some 10% say they don't offer it because of unclear or excessive potential fiduciary liability, up from 2% in 2010. Several other concerns declined during the past two years, including "inappropriate in the current economic environment" (from 18% in 2010 to 12% in 2012), "too costly from a company match perspective" (18% to 12%) and "too expensive to implement" (12% to 6%). We were pleased to see that 30% are somewhat or very likely to add automatic enrollment in the next 12 months, up from 16% in 2010. Meanwhile, 48% of plan sponsors without automatic enrollment are very unlikely to add it, which is a welcome drop from 65% in 2010.

Fig. 8 Likelihood of adding automatic enrollment in the next 12 months



2010, n=57 2012, n=52

Fig. 9 Reasons for not offering automatic enrollment



Automatic contribution escalation

In one of the survey's more surprising findings, automatic contribution escalation has not increased in prevalence since 2010: The percentage of plans offering it has nominally changed from 46% to just 47%. And only 19% of plans offer automatic contribution escalation in conjunction with automatic enrollment, which also reflects little to no change since two years ago. Used together, the two programs offer a powerful opportunity to improve participant outcomes, making the lack of progress in this area a source of particular concern.

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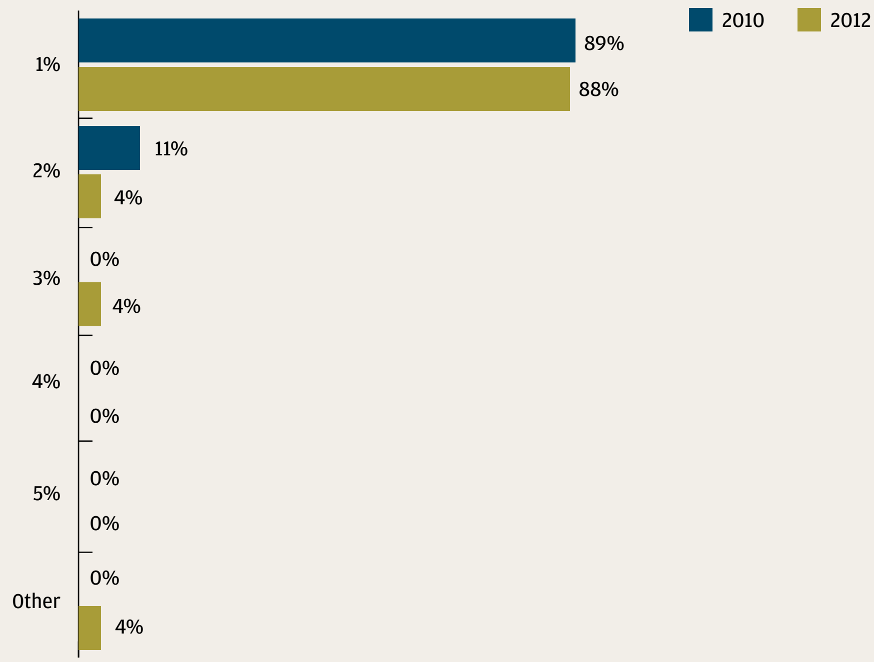
One sign of progress in automatic contribution escalation: Some employers have moved to a higher cap on auto-escalated savings rates. Many still place the cap at 6% (41% versus 47% in 2010). But nearly half (46%) of plans with automatic contribution escalation now have a cap of 10% or higher, up from 31% in 2010. (To qualify for the non-discrimination testing safe harbor, plans' automatic contribution escalation cannot exceed 10%.)

While plans with automatic contribution escalation appear to be embracing it more vigorously, they could go farther. In particular, the vast majority of automatic contribution escalation programs increase contribution rates by only one percentage point per year (Fig. 9). With a 3% default contribution rate and a one-point annual increase, it will take many participants at least seven years before they reach the double-digit rate most plan sponsors identify as optimal.

Fig. 10 Current annual automatic contribution increase rate



2010, n=19 2012, n=26

Matching contributions

Nearly all respondents offer some type of employer contribution in their plan. Only 4% said they do not, down from 19% in 2010. Plan sponsors are eyeing the match as a lever to encourage higher savings rates, with about a quarter (22%) saying that they are likely to change the structure of their employer contribution to drive increased saving.

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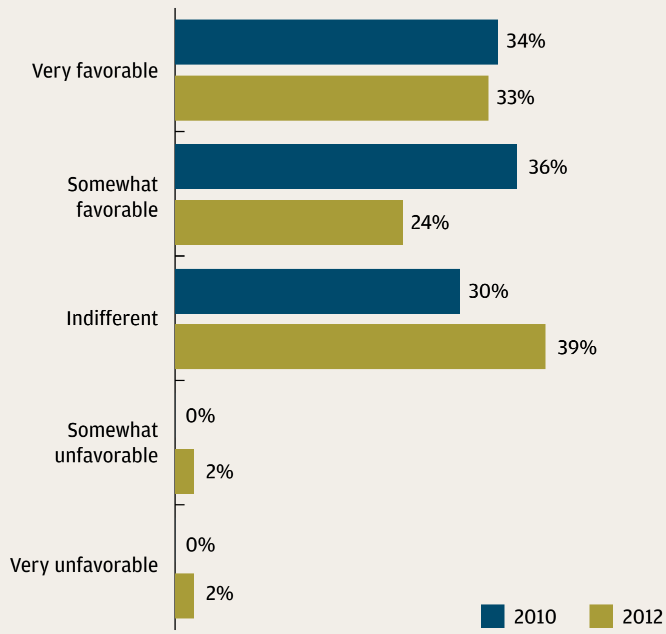
Participant satisfaction

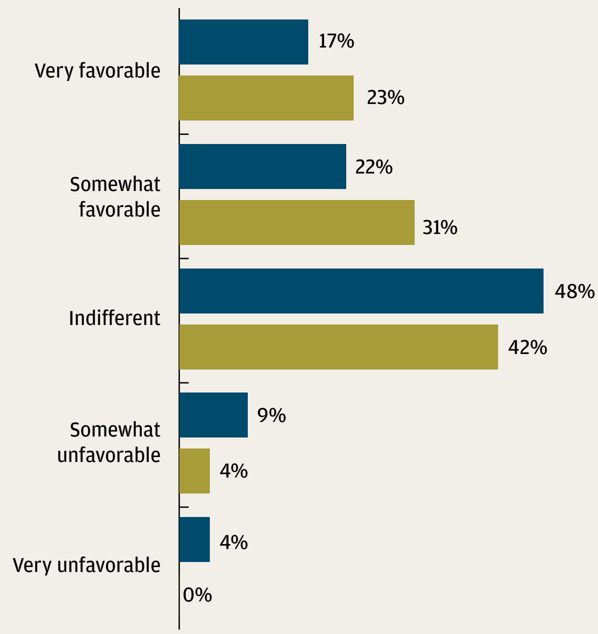
The majority of respondents report that participants are satisfied with automatic programs: 62% report opt-out rates of less than 10% for automatic enrollment, while 67% report opt-out rates below 10% for automatic contribution escalation. More subjectively, more than half of plan sponsors describe their employees' attitudes toward automatic enrollment and automatic contribution escalation as very or somewhat favorable (57% and 54%, respectively).

Fig. 11 Plan sponsors' description of participant attitude toward automatic enrollment



2010, n=44 2012, n=66

Fig. 12 Plan sponsors' description of participant attitude toward automatic contribution escalation



2010, n=19 2012, n=26

While perceived favorability of automatic enrollment fell, from 70% to 57%, the greater representation of small plans in the 2012 Survey explains at least part of this shift. Small plans were much less likely than large plans to report favorable attitudes toward automatic enrollment, partially skewing the decline in perceived attitudes toward this feature.

Re-enrollment

There continues to be widespread misunderstanding of the concept of plan re-enrollment. A re-enrollment gives plan participants the opportunity to make new investment elections. If participants do not make a new investment election, the plan will invest their existing assets and future contributions in the plan's default option, typically a target date fund. Implementing this type of strategy can quickly enable a plan to improve overall asset allocation.

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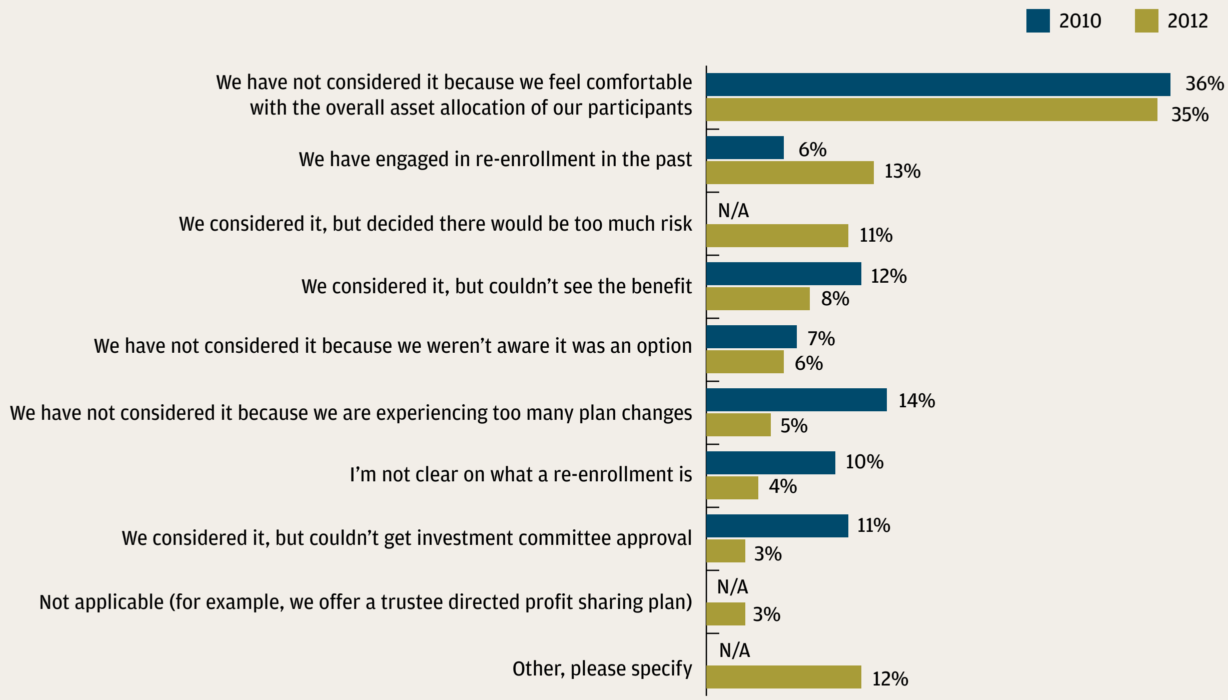
There has been some improvement in the percentage of plans that have conducted a one-time plan re-enrollment, but the number is still very low (13% in 2012 compared to 6% in 2010). The two most common reasons plan sponsors state for not using re-enrollment is perceived risk (11%) and a lack of certainty about what re-enrollment is or knowledge that it is an option (10%).

Fig. 13 Views of conducting a one-time re-enrollment



2010, n=101 2012, n=118

Participant communications

Of plans that offer automatic enrollment, 41% say that their participant communication program has not changed since they added the feature. Some 39% say they have increased their level of communication, while 23% provide the same amount of communication but focus on different topics and 14% provide personalized projections. No respondents said they provide less communication to participants since the addition of automatic enrollment, suggesting that plan sponsors are following through on their stated belief in the importance of participant communications—and indicating that plan sponsors do not believe that automation can replace communications.

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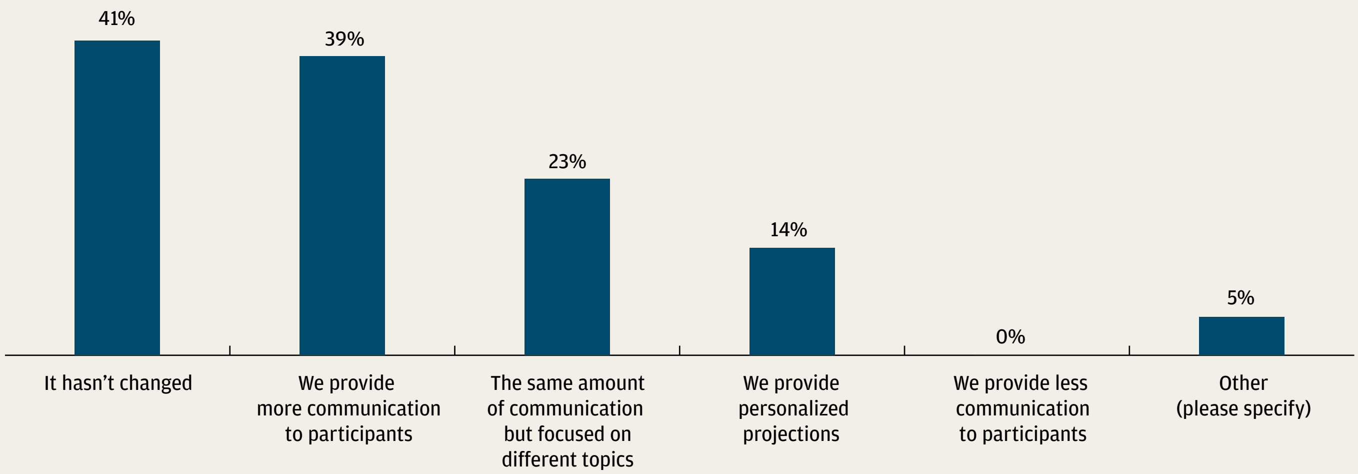
Fig. 14 Changes in communication level since adding automatic features



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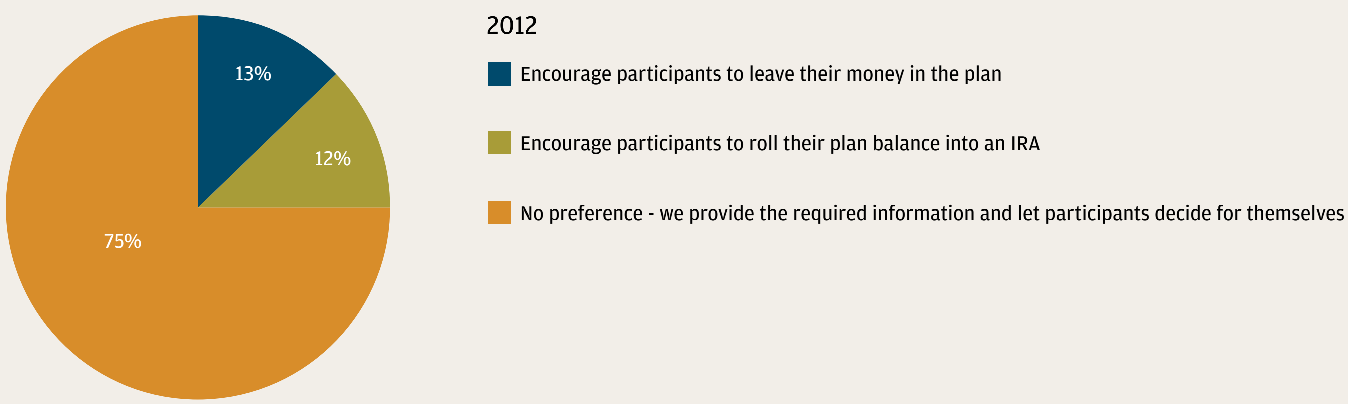
A small number of plan sponsors encourage terminating participants to leave money in the plan (13%) or to roll it over to an IRA (12%). Some three-quarters of respondents indicated that they provide only the required information and allow participants to make their own decisions, suggesting that plan exit at retirement remains a low priority for most plan sponsors. This area offers room for improvement for plan sponsors looking for ways to support participants' retirement readiness.

Fig. 15 Communication with departing employees



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Retirement income solutions

When asked whether they were likely to implement an in-plan retirement income solution, 46% stated that they were not—but 31% expect to implement such a solution in the next three to five years and 9% in one to two years. Just 14% reported currently offering a solution. The most common reason for not offering a retirement income solution was that solutions are still evolving (62%). Other popular answers included portability issues (33%) and regulatory uncertainty (30%).

Fig. 16 Likelihood of offering retirement income solution

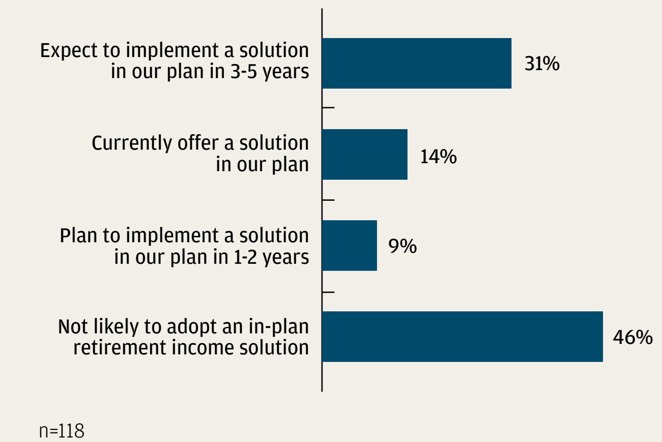
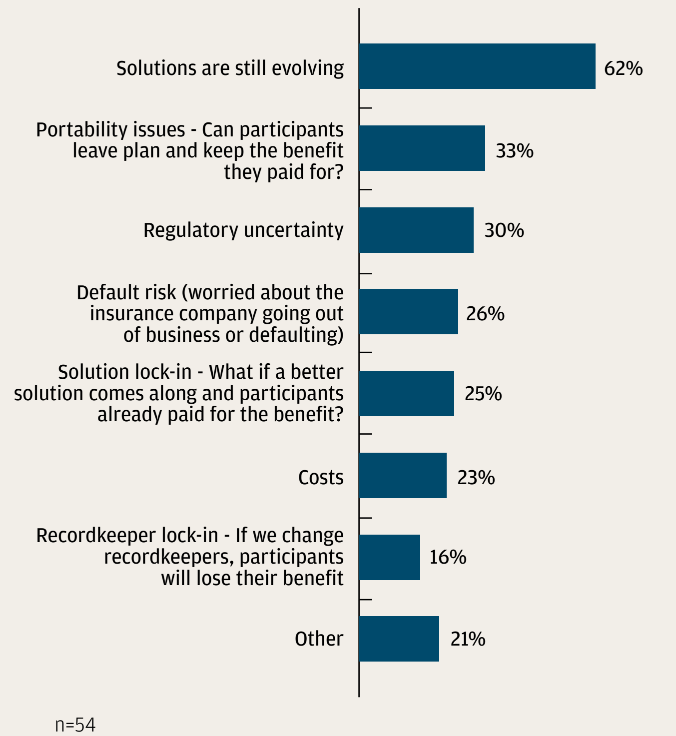


Fig. 17 Reasons for not offering retirement income solution



Summary

The 2012 Plan Sponsor Survey indicates that the defined contribution industry is making progress addressing the needs of participants, but also that it needs to take further action to build DC plans that truly support retirement readiness. The gap between the optimal contribution rates identified by plan sponsors and the rates their plan features currently encourage cast an especially bright light on the work that remains be done.

Fortunately, plan sponsors have clear options to advance the efficacy of their plans. In particular, they can take steps to optimize the use and impact of automatic features: implementing both automatic enrollment and automatic contribution escalation, and escalating contributions by two percentage points per year to nudge participants to contribution rates of 10% or more as quickly as possible.

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About DCIIA

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

DCIIA's mission is underpinned by five core beliefs:

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

To further its mission, DCIIA:

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