Defined contribution retirement plans take center stage

Executive summary: 2017 Defined Contribution Plan Sponsor Survey
After years of building, the trend toward a retirement landscape centered on defined contribution (DC) plans has finally reached its inevitable climax. The vast majority of plan sponsors (81%) now offer only a 401(k) or other DC retirement plan to new employees. The old, and effective, retirement income equation — comprised of traditional defined benefit (DB) pension plan payments, DC plan assets and Social Security benefits — is no longer the default strategy for most future retirees.

Even though they were never designed or expected to be the primary vehicle for retirement income, it appears that DC plans have now assumed that role. This reality has important implications for both retirement plans and the people participating in them, as both employees and employers share responsibility for retirement savings. As a result, plan sponsors need to take a more active role in helping employees navigate their own retirement journey. Our survey reveals some ways retirement planning can and should change to support this new role in a predominantly DC-based retirement landscape.
Plan design still at the core

One place to start making changes is in plan design. Given the growing importance of DC plans, it’s not surprising that an increasing number of plan sponsors want to make sure these plans are as effective as possible and enable participants to retire at the appropriate time. Although plan sponsors provide the basics, such as matching contributions and strong investment options, as a matter of course, there are still more opportunities for plan sponsors to leverage plan design to ensure better outcomes for participants. For example, effective plan design in this environment means first getting as many employees as possible to participate in the plan, then helping them allocate their assets and make better overall choices to maximize their plan outcomes.

In many cases, using DC plan design in this way requires plan sponsors to expand their focus beyond their usual plan-related activities. For example, instead of focusing primarily on legal and regulatory issues and the plan’s investments, plan sponsors can explore ways to optimize their DC plans to improve employees’ overall financial well-being and retirement readiness. Some plan sponsors have already adopted this broader focus on participant outcomes, but there are still more opportunities for plan sponsors to take greater action.

Plan sponsors are taking steps to improve outcomes...

Our survey found that employers are enhancing their DC plans so that plan participants are encouraged to save more and make wiser investment decisions, through:

- **Raising participation levels:** For many plan sponsors, improving plan participation levels is an important first step toward greater retirement readiness. Nearly three-quarters of plan sponsors have an automatic enrollment feature, a change that has definitely contributed to higher plan participation rates and is helping to increase average plan-level contribution rates. Half of DC plans automatically enroll new participants and include default contribution rates that are at least enough to maximize the employer match. In addition, 60% of plans also automatically increase employee contributions annually.

- **Streamlining investment options:** Once employees are in the plan, more plan sponsors are looking for ways to leverage investment options for better participant outcomes. This focus on investment is not new. What is new are plan sponsor efforts to go beyond offering investments that simply represent an appropriate number and variety of asset classes.

Many plan sponsors are changing and streamlining plan investment options with an eye toward helping participants make better choices. In addition, target date funds have largely replaced lower risk/lower return investment options, like stable value funds, as the default investment choice for those who are automatically enrolled. However, the use of target date funds requires diligent tracking to ensure that these funds have a “glide path” guiding the investment mix to meet the needs of the participant population and to maximize the potential retirement readiness of those investing.
**Enhancing plan design:** Plan sponsors are also paying more attention to plan basics — such as increasing employer contributions and lowering plan administration fees — that enhance outcomes for plan participants. For example, carefully managing plan fees can help improve participant returns on their retirement assets and boost overall plan performance without adding anything to the cost of the plan. Taking action yields results. Nearly 60% of plan sponsors were able to reduce administrative fees and 34% reduced investment fees, according to our survey.

Plan sponsors are also making changes that give participants more flexibility and opportunities to broaden retirement planning strategies. For example, 70% of plan sponsors have added a Roth feature to their plans, while another 15% are planning to add this option or considering doing so. A Roth feature lets participants make aftertax contributions that allow future retirement withdrawals to be tax-free. Employees can still choose to contribute pretax money while future retirement withdrawals are taxable, as is the case in a traditional 401(k) plan, even if the Roth feature is available.

Use of the Roth feature has grown significantly since 2014 when only 52% had it available in their plans. By helping employees understand the Roth feature and how it fits into their retirement planning, plan sponsors can help participants to assess whether this approach would be appropriate for maximizing their individual outcomes.

**Looking outside the retirement plan:** Adding retirement planning tools outside of the DC plan is also an increasingly common way for plan sponsors to help support better participant outcomes. The growing popularity of health savings accounts (HSAs) is an important development in this area. HSAs allow employees to set aside tax-free dollars from their paychecks that they can use to pay for qualified medical expenses, also tax-free, now or in retirement. This money remains with the employee even if he or she should leave the company. Our survey results indicate that 80% of plan sponsors are now offering HSAs, up from 59% in 2014, and 8% are planning to or considering doing so. This development shows that plan sponsors are focusing on the impact of future health care costs on retirement readiness. It also demonstrates employers’ interest in meeting a growing concern among participants about how they will be able to pay for health care costs in retirement.
...While opportunities exist to do even more

Many plan sponsors are indeed making progress toward their goal of increasing participant retirement readiness. However, our survey indicates there is still more work to be done, including:

- **Making retirement readiness a priority:** Although 60% of plan sponsors place “improving retirement readiness” as one of their top three priorities, the reality is that legal and regulatory concerns require many sponsors to spend a great deal of time monitoring plan investments. For example, 83% of fiduciary committees at the largest plan sponsors say their top priority is to improve retirement readiness and associated workforce risks, yet only 17% spend time at meetings on retirement readiness. Instead, these committees use a vast majority of their time (82%) monitoring the performance of investment managers.

We believe one way to improve retirement readiness is to engage participants in monitoring and improving their own results. By providing robust planning tools that help participants understand where they stand relative to their retirement goals, and steps they can take to improve that standing, plan sponsors can not only educate participants but also look to increase participant engagement in their plans. In many cases, this simply involves promoting planning tools that are already available, such as mobile apps and online modeling tools (e.g., retirement calculators). Even though 68% of plan sponsors view these types of tools as effective, our survey found that only 24% say that these tools are highly utilized by participants.
- **Delegating some investment responsibilities**: The focus on legal/regulatory concerns and monitoring investments has paid off with most plan sponsors saying they feel comfortable with how they manage these issues. As a result, plan sponsors should now be confident enough to expand their focus to include actions to improve retirement readiness and participant outcomes.

  With this in mind, we feel plan sponsors should evaluate the benefits of delegating their investment decisions, either to an internal subcommittee or to an external third party, so they can focus on strategies to address their top priorities. With this approach, we believe DC plan investment committees could have more time to concentrate on improving participant engagement and outcomes, rather than focusing on individual asset classes and investment fund monitoring.

- **Measuring outcomes**: As they expand their focus to include retirement readiness, plan sponsors should assess the current state of retirement readiness among plan participants in order to establish a level against which to measure future improvement. However, only about one-third of plan sponsors annually measure when participants will have enough money to retire and less than 50% do so at least every three years. If plan sponsors make a commitment to measure retirement readiness regularly, we feel they will be better prepared to develop and implement specific strategies to address any areas where participants are falling short.

  Our survey also indicates that 88% of sponsors use plan statistics to assess retirement readiness, such as average participation rate, account balance and contribution rate. Yet, there are more opportunities to dig deeper and get a feel for where people stand relative to their individual retirement goals and then develop strategies to help improve that standing. For example, only about one-third of plan sponsors use rule of thumb metrics (such as replacement ratio or pay multiplier) and one-quarter conduct more sophisticated individual projections of retirement resources and overall retirement income needs.

- **Balancing costs today versus costs tomorrow**: Our survey indicates that larger DC plans are clearly leading the way in both measuring retirement readiness and taking steps to improve it. It is difficult for cost-conscious smaller plans to keep up with current trends in plan design to improve participant outcomes. For example, nearly half of plan sponsors that do not use automatic enrollment cite costs as the reason for not implementing this feature. Considering that automatic enrollment is a tool to help improve plan participation — plans with this feature average 90% participation rates compared with 68% for plans without it — these smaller plans are increasingly likely to face workforce challenges if older workers can't afford to retire at the appropriate time.

  ![Our survey also indicates that 88% of sponsors use plan statistics to assess retirement readiness, such as average participation rate, account balance and contribution rate.](image-url)
Conclusion

Retirement readiness is a growing concern for plan sponsors, and with good reason. Now that DC plans dominate the retirement landscape, employees share in the responsibility for having adequate income in retirement.

Yet, other financial pressures are also coming to bear on these individuals. Employees are assuming a greater share of their current health care costs, adding to the financial strain many of them feel. This financial stress often limits their ability to save for retirement, thereby increasing the potential for future financial stress as employees realize that their savings may fall short of what they need for a secure retirement.

All of these forces are making employee financial well-being an increasingly important issue for employers. By offering a holistic financial well-being framework that incorporates employees’ perceptions and concerns as well as measures of fund performance, we believe employers can help employees navigate the choices available to them. Helping employees manage, and ultimately achieve, their current and future financial goals should be a priority as the era of DC plans enters maturity.
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