Ready, Set, Retire

Using Defined Contribution Plans to Improve Retirement Readiness

2014
“Defined contribution plans have come a long way in helping workers build adequate retirement savings. The increasing use of automated savings features, target-date funds, simplified investment lineups and transparent fees is creating a better environment for employees to build and protect their retirement savings.

Unfortunately, these efforts are not sufficient, as many employers are concerned their employees will not be ready to retire as planned.”
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American workers are becoming more accustomed to making decisions about their own retirement and health care. At the same time, organizations are starting to reevaluate their role in this paradigm, including what it means for their business when employees delay retirement because they can’t afford to stop working.

The risk of delayed retirements is multidimensional. Our research shows that employees who continue to work only because they lack the savings to retire are less likely to be highly engaged and as productive as other workers. From a financial perspective, longer-tenured workers often earn higher salaries and incur greater health care costs. The lack of orderly transition in the workplace can also have broad implications. When workers stay in their roles past projected retirement dates, they can block other employees’ career paths, increasing an employer’s risk of losing critical talent, potential leaders and new skill sets.

Defined contribution (DC) plans have come a long way in helping workers build adequate retirement savings. The increasing use of automated savings features, target-date funds (TDFs), simplified investment lineups and transparent...
fees is creating a better environment for employees to build and protect their retirement savings.

Unfortunately, these efforts are not sufficient, as many employers are concerned their employees will not be ready to retire as planned. Employers are balancing the need to improve the retirement readiness of their workers with the need to overcome financial constraints, siloed benefit planning and an overemphasis on competitiveness. In addition, many plan features that could help employees get ready for retirement are either not widely used or still in their relative infancy.

The good news for employers is that significant opportunity exists to optimize their DC programs. But to make them as efficient and results-based as possible, companies need to monitor and measure their programs’ effectiveness in helping employees reach their savings goals. Only then will they be able to identify the right design, investment and communication features for their organization among the many tools available. Employers that take these steps are more likely to find the best opportunities for implementing needed change — and ultimately benefit both their employees and their organizations.

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Key Findings

- **Automatic enrollment in DC plans is commonplace, but companies are missing opportunities to increase its value by adding automatic deferral increases.** More than two-thirds of companies (68%) offer automatic enrollment to at least some of their workers, but far fewer automatically reenroll noncontributors or those deferring less than the default amount. Similarly, while automatic escalation of deferrals has been shown to increase savings, the number of companies that mandate it remains low. Of the companies that offer automatic enrollment, only 35% mandate automatic escalation.

- **Utilization of Roth features remains low among participants despite growing availability.** More than half (54%) of employers offer Roth features, yet they remain underutilized. Only 8% of highly compensated employees and 11% of non-highly compensated employees take advantage of this feature.

- **Greater coordination of DC and health savings account (HSA) messages could improve readiness.** Only 1% of the organizations that offer DC and HSA plans set their contributions in an integrated fashion. In addition, of the employers that offer both plan types, just 19% educate workers about the wealth accumulation benefits of saving through the DC plan versus saving in the HSA.

- **Companies continue to simplify the investment choices in their plans.** More than two in five companies (43%) have streamlined their investment offerings in the last five years with a strong bias toward continuing to decrease their options in the next 12 months.

- **Custom TDFs are gaining traction.** Forty-nine percent of plan sponsors see the value of a custom TDF, which allows employers to align the glide path, portfolio construction and implementation of the funds to their plan objectives and participant demographics.

- **Interest is growing in outsourcing investment services.** One-third of respondents are either already in an outsourced DC solution or expressing interest in delegating all or a portion of their plan oversight.

- **Most companies are requiring participants to pay direct fees.** Since 2009, the percentage of companies requiring employees to pay direct recordkeeping fees has risen from 33% to 58%. Currently, only 23% of employers still absorb the cost themselves.

- **Employee knowledge and confidence gaps are barriers to saving.** Retirement readiness is a partnership — both companies and their employees must understand their roles in addressing it — but the gaps in employee knowledge are significant. Only 12% of companies say their employees know how much to save, and just 20% believe their employees are comfortable making investment decisions.

- **Improving communication and adding new approaches will be a top priority in the next two to three years.** To address the shortfall in employee knowledge, most companies say they will devote more attention to employee education and communication. More active communication tools, such as mobile apps and gamification, offer new ways to reach employees and deliver more personalized information that has a higher chance of changing saving behaviors.
Participation rates

Employee participation in DC plans has improved over the last several years, largely due to automatic enrollment. The number of companies with more than 80% of employees participating in their DC plans grew from 50% in our 2010 study to 64% in 2014. Today, more than two-thirds (68%) offer automatic enrollment to all or newly hired workers, up from 57% in 2010.

Employers have the opportunity to engage slow or stagnant savers by reenrolling noncontributors or those deferring less than the automatic enrollment default. (Currently, only 26% are reenrolling these participants.) Fifty-four percent of companies provide automatic escalation (Figure 1), but only 28% mandate it (Figure 2). Among sponsors that automatically enroll some or all workers, approximately two-thirds offer automatic escalation of contributions, with 35% making it mandatory.

Adding plan provisions that improve saving behaviors — such as notifying employees that updating their deferral percentage can be done incrementally, not just annually or at sign-up — can set a model for the type of thinking that improves retirement readiness and provides a touchpoint for educational campaigns.

Aside from automatic enrollment and automatic escalation, the appeal of an employer match continues to be one of the single largest influencers of the amount and level of employee savings. Currently, 95% of plan sponsors offer a matching contribution to some or all of their workers. One-third of employees save at the match threshold and another third save more than the threshold (Figure 3, next page). Workers are also most likely to defer over the match threshold when an automatic contribution escalation is in place. Knowing that many employees tend to save at the match threshold provides the opportunity for employers to reshape the match to encourage increased levels of savings and improved retirement readiness. Providing the match as deferrals are made, usually from paychecks, is still most common. In fact, despite recent public debates suggesting an annual match offers employers savings, only 7% of respondents allocate their match annually.

Figure 1. Automatic escalation is on the rise

Figure 2. Most respondents do not mandate automatic escalation

Is automatic contribution escalation mandated?

Yes: 28%
No: 72%

n = 457
Roth provisions

Roth provisions offer a springboard for educational efforts and for employees to understand the power of tax-deferred earnings. And our analysis suggests employees may benefit from education on this topic. More than half of companies offer a Roth option, yet this option remains underutilized.

Fifty-four percent of companies offer Roth features, up from 46% in 2012. Additionally, 18% of respondents are planning or considering adding Roth features by 2016. Of those that currently offer Roth, 45% also allow other aftertax contributions. While this option has increased, utilization still remains very low, with only 8% of highly compensated employees and 11% of non-highly compensated employees using Roth options for savings (Figure 4).

Organizations that want to be proactive about driving up the use of their Roth provisions have many more options than in the past for targeting messages to employees not currently making Roth contributions.

“Organizations that want to be proactive about driving up the use of their Roth provisions have many more options than in the past for targeting messages to employees not currently making Roth contributions.”
HSAs

Today, a majority (59%) of companies offer an HSA as part of their account-based health plans. However, only one-third (32%) of eligible employees are taking advantage of this option, with higher enrollment rates reported by companies with larger assets.

The 2013/2014 Towers Watson Global Benefit Attitudes Study confirms that employees are concerned about health care costs in retirement. Roughly only half of all employees expect to be able to afford the health care they will need after retiring, and older workers, those in poor health and undersavers are particularly worried. Making the effort to increase employee awareness and understanding of available HSA accounts can be worthwhile if you want to ease these concerns, advance the mark on retirement readiness and offer tax advantages. Incentives, like an employer HSA contribution, can drive employee savings. So some analysis of your DC and HSA contribution strategy could offer helpful perspective.

Changes to HSA and DC contribution levels are an emerging trend. Twenty-three percent of employers that offer DC and HSA plans intend to increase their total contributions toward these plans over the next two to three years (Figure 5).

Figure 5. Some employers plan to increase the contribution for their DC and HSA plans

<table>
<thead>
<tr>
<th></th>
<th>Increase</th>
<th>Decrease</th>
<th>No change</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>DC plans</td>
<td>16</td>
<td>3</td>
<td>81</td>
<td>90</td>
</tr>
<tr>
<td>HSA plans</td>
<td>21</td>
<td>8</td>
<td>72</td>
<td>70</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>7</td>
<td>70</td>
<td>90</td>
</tr>
</tbody>
</table>

n = 213

Coordinate Financial Well-Being Messages

Integrating HSA and DC contributions offers employees tax efficiency, but nearly every company (99%) sets DC and HSA contributions independently. Of those that offer HSAs, only one in five (19%) specifically educate their workers on the wealth accumulation benefits of saving through a DC plan versus an HSA.
Investments

The evolution of investment offerings has come full circle since the inception of DC plans. The first plans generally offered a few diversified choices, but over time, many organizations offered an overwhelming number of options. Today, we are again seeing employers streamline the number of investment options they offer to employees. More than two in five (43%) companies have streamlined their investment offerings in the last five years with a strong bias toward continuing to decrease options in the next 12 months (Figure 6). Three-quarters (74%) of plans currently maintain fewer than 20 options, with the majority offering between 10 and 19 investment choices (Figure 7).

### Investment Trends in DC Plans

- Companies continue to simplify their investment choices.
- A combination of passive and active choices is most common.
- Active management is being approached in a more diversified manner.
- TDFs are used in almost all plans, and custom TDFs are gaining traction.
- Sponsors are beginning to pursue the delegation of fiduciary decisions.
Emerging investment trends

The vast majority of companies (79%) offer a combination of active and passive options throughout their portfolios (Figure 8). Approximately one in 10 offer either active-only or passive-only choices.

The understanding that active management efficiency is better achieved through multi-manager structures is growing. Participant use of single, stand-alone options has been inefficient, and 40% of companies recognize that combining investment strategies is more effective.

One emerging trend for investment lineups is custom TDFs. Unbundling the key decision points enables employers to align the glide path, portfolio construction and fund implementation to their plan objectives and participant demographics. Half of companies (49%) say they see the value of a custom TDF series and either have implemented one or may explore the option (Figure 9).

“One emerging trend for investment lineups is custom TDFs.”
As the primary retirement vehicle, DC plans now require more time, attention and expertise from companies than ever before. As a result, outsourcing investment services is gaining traction. One-third of respondents are either already in an outsourced DC solution or have expressed interest in delegating all or a portion of their plan oversight (Figure 10), with smaller plans more interested in outsourcing than their larger counterparts.

While lifetime income options are intended to improve retirement readiness, these new solutions are immature, and early adopters face opportunities and challenges. Several relevant factors in the market landscape, solution types and regulations have yet to be determined.

The number of companies offering lifetime income options remains fairly low, at just 12%. While that’s double the number in 2012, the percentage of companies considering adding lifetime income offerings dropped considerably between 2012 and today (31% to 12%). Low utilization rates are one likely driver of the drop in interest (Figure 11). When offered to retiring participants, lifetime income distribution is chosen by less than 5%.

**Figure 10. Attitudes toward outsourcing oversight**

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>$10 million to $199 million</th>
<th>$200 million to $499 million</th>
<th>$500 million to $999 million</th>
<th>$1 billion or greater</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prefer not to delegate investment oversight of our DC plan at this time</td>
<td>64%</td>
<td>52%</td>
<td>61%</td>
<td>65%</td>
<td>70%</td>
</tr>
<tr>
<td>May be interested in exploring delegated investment oversight for our DC plan</td>
<td>10%</td>
<td>16%</td>
<td>12%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Interested in exploring delegating certain areas of investment oversight for our DC plan (e.g., TDFs)</td>
<td>3%</td>
<td>6%</td>
<td>2%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>DC plan is currently in a delegated investment solution</td>
<td>18%</td>
<td>23%</td>
<td>22%</td>
<td>21%</td>
<td>13%</td>
</tr>
<tr>
<td>Other</td>
<td>5%</td>
<td>3%</td>
<td>3%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>n = 457</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 11. Factors driving disinterest in lifetime income options**

<table>
<thead>
<tr>
<th>Factor</th>
<th>0%</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of participant demand</td>
<td></td>
<td></td>
<td></td>
<td>57%</td>
</tr>
<tr>
<td>Fiduciary risk/Lack of clarity regarding safe harbor</td>
<td>41%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative complexity</td>
<td></td>
<td></td>
<td></td>
<td>41%</td>
</tr>
<tr>
<td>Unfamiliar with market offerings</td>
<td></td>
<td></td>
<td>24%</td>
<td></td>
</tr>
<tr>
<td>Cost</td>
<td></td>
<td></td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>Market offerings are not satisfactory</td>
<td>18%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>n = 345</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Employer stock

Employer stock is still prevalent in DC plans. Very large plans are more likely to offer company stock than smaller plans. However, no companies are considering adding it in the future (Figure 12).

Figure 12. Percentage of companies offering employer stock
Fees affect employees’ ability to be ready for retirement. When employees are required to pay fees, they are taken directly from participant account balances, so the higher the fees, the less employees have in the market. Over time, the impact can be sizable.

Forty percent calculate and charge an asset-based fee based on the performance of the investment funds, while 32% charge a fixed dollar amount per member. Fifteen percent have a mix, where some recordkeeping fees are calculated as a fixed dollar amount per member and the remainder is charged as an asset-based fee netted from the performance on the investment funds (Figure 13).

Since 2009, the percentage of companies requiring employees to pay direct recordkeeping fees has risen from 33% in 2009 to nearly 60% passing the full cost on to participants today (Figure 14). In fact, only 23% of employers absorb the cost themselves.

Adoption of a fee policy is a good practice and can be one component of optimal plan management. Most employers have conducted a high-value fee benchmarking study in the last three years, leading nearly half (48%) to reduce administrative fees and 34% to reduce investment expenses (Figure 15).

“Since 2009, the percentage of companies requiring employees to pay direct recordkeeping fees has risen from 33% in 2009 to nearly 60% passing the full cost on to participants today.”
Survey results show that employers rely heavily on traditional, passive communication methods (e.g., account statements, newsletters, group meetings, online education, webcasts) (Figure 16) and that those methods are not working.

Only 12% of respondents say employees know how much to save, and only 20% say employees feel comfortable making investment decisions.

However, employers are showing signs that they are ready to make a more substantial investment in communications, with 84% reporting that they expect to increase efforts to educate employees on saving and investing over the next two or three years (Figure 17). More importantly, 78% say they will increase their use of technology to deliver information to employees over that same time period.

Increased use of technology opens the door for new ways to build participant engagement and increase the likelihood they will take action. However, using technology without a strategy for implementation, measuring results and refining the process does not guarantee it will result in participant engagement and behavior change. To increase the likelihood of effectiveness, the communication strategy should be based on data that provide a thorough understanding of all participants and what motivates their behavior.

78% say they will increase their use of technology to deliver information to employees.

**Figure 16. Employers use multiple methods to communicate with employees**

<table>
<thead>
<tr>
<th>Method</th>
<th>0%</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
<th>80%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account statements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>62</td>
<td>36</td>
</tr>
<tr>
<td>Email blasts</td>
<td>27</td>
<td></td>
<td>54</td>
<td></td>
<td></td>
<td>19</td>
</tr>
<tr>
<td>Newsletters</td>
<td>22</td>
<td></td>
<td>59</td>
<td></td>
<td></td>
<td>19</td>
</tr>
<tr>
<td>Online education/Webcasts</td>
<td>22</td>
<td></td>
<td>62</td>
<td></td>
<td></td>
<td>16</td>
</tr>
<tr>
<td>Investment advice</td>
<td>22</td>
<td></td>
<td>48</td>
<td></td>
<td></td>
<td>30</td>
</tr>
<tr>
<td>Managed account services</td>
<td>17</td>
<td></td>
<td>38</td>
<td></td>
<td></td>
<td>45</td>
</tr>
<tr>
<td>Group meetings with participants</td>
<td>16</td>
<td></td>
<td>71</td>
<td></td>
<td></td>
<td>13</td>
</tr>
<tr>
<td>One-on-one meetings with participants</td>
<td>14</td>
<td></td>
<td>53</td>
<td></td>
<td></td>
<td>33</td>
</tr>
<tr>
<td>Mobile applications</td>
<td>9</td>
<td></td>
<td>50</td>
<td></td>
<td></td>
<td>41</td>
</tr>
<tr>
<td>Gamification</td>
<td>8</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>92</td>
</tr>
</tbody>
</table>

**Figure 17. Employers expect to increase employee communication**

<table>
<thead>
<tr>
<th>Statement</th>
<th>0%</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
<th>80%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our organization expects to increase our efforts to educate employees on saving and investing for retirement within the next two to three years</td>
<td>84</td>
<td></td>
<td></td>
<td></td>
<td>13</td>
<td>3</td>
</tr>
<tr>
<td>Our employees feel comfortable making decisions on how their retirement savings are invested</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
<td>49</td>
<td>31</td>
</tr>
</tbody>
</table>

n = 457
One approach employers are using to gain knowledge of their participants and design communication campaigns is microsegmentation, which is a proven market research tactic that leverages data to identify communication preferences, buying habits and other behavioral tendencies. Data can also be used to deliver content that is timelier and more relevant, reaching employees when they are most likely to act, such as after a life event or transition to a different life stage.

Armed with this knowledge, employers are able to use the right technology in more targeted ways to reach participants more effectively, such as through gamification, online contests and questionnaires, mobile apps and electronic bulletin boards. When used strategically, the increased accessibility and low cost of mobile apps, gamification methods and other technology solutions offer plan sponsors new ways to reach employees and more alternatives for helping them make better, more informed financial decisions.

Communication Trends

Improving employee confidence in retirement security is a top objective.

Companies would benefit from implementing new approaches, including mobile apps and gamification.
Recommendations to Increase Retirement Readiness

The formula for igniting retirement readiness progress is far from a one-size-fits-all blueprint. Recommended actions for both employees and employers vary based on a wide range of circumstances. However, given the expanding number of workers that will rely largely on their DC plan for retirement savings in the future, nearly all employers have a growing opportunity to offer and maintain a supportive environment for building adequate retirement savings. If you strive to improve retirement readiness at your organization, consider the following recommendations:

• **Take steps to analyze your DC plan provisions with results in mind.** This will broaden your consideration to include related health care factors and help you make decisions based on what is appropriate for your plan, given the unique needs of your employee demographics.

• **Meet the needs of different participants and facilitate more effective investment behavior by maintaining a simple investment lineup of diverse options structured in tiers.** A tiered investment structure generally consists of TDFs, index options, a limited series of active options and optional self-directed solutions.

• **Implement a fee policy statement that includes a prudent schedule for fee reviews.** This practice will help you manage your DC plan vendors, and could result in cost savings — and better retirement readiness — for employees.

• **Utilize action-oriented and personalized communication methods.** Addressing the right message at the right time to a targeted audience can increase the odds of changing behavior.

• **Measure the effectiveness of your DC plan based on how well the plan is helping employees meet their saving goals.** This involves looking beyond participation, deferral rates and asset allocations. Determine if there are opportunities where the various design, investment and communication features can be used more effectively.
The 2014 Towers Watson North American Defined Contribution Plan Sponsor Survey was conducted in June and July 2014, and includes responses from 457 large and midsize U.S. companies that sponsor a DC plan. These companies sponsor 401(k) plans or 403(b) plans, represent a range of industry sectors, and have more than 1,000 employees and $10 million or more in assets.

**Figure 18. Respondent plan asset size**

- **15%** $10 million to $199 million
- **25%** $200 million to $499 million
- **23%** $500 million to $999 million
- **37%** $1 billion and greater

n = 457

**Figure 19. Respondent industry sector**

- **Financial Services** 17%
- **Health Care** 14%
- **Manufacturing** 14%
- **Energy** 13%
- **High Technology** 6%
- **Retail** 5%
- **Automobiles and Transportation** 3%
- **Chemicals** 3%
- **Food and Beverage** 3%
- **Aerospace and Defense** 2%
- **Consumer goods** 2%
- **Entertainment** 2%
- **Mining and Natural Resources** 2%
- **Professional and Business Services** 2%
- **Communication** 1%
- **Education** 1%
- **Hospitality** 1%
- **Publishing** 1%
- **Telecommunications** 1%
- **Transportation** 1%
- **Wholesale** 1%
- **Other** 5%

n = 457
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