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## 10 Years Later **THE PENSION PROTECTION ACT'S IMPACT ON DEFINED CONTRIBUTION PLANS**

When President George W. Bush signed the Pension Protection Act 10 years ago, he called it the “most sweeping reform of America’s pension laws in over 30 years.”

While many challenges remain for Americans to achieve financial security in retirement, this act and the subsequent rules established by the Department of Labor, have produced significant progress in helping many more people become better financially prepared for retirement. Although primarily aimed at defined benefit plans, the PPA also affected the design of defined contribution plans. Most notably, it paved the way for auto-enrollment and also established QDIAs (Qualified Default Investment Alternatives) which include target date funds.

Since 2006, the impact of this legislation for defined contribution plans has been substantial. Consider:

- 61% of plans use auto enrollment, compared to 35% in 2006<sup>1</sup>
- 73% of plans use target date funds, compared to 32% in 2006<sup>2</sup>
- 45.9% of plans use auto increase, compared to 26% in 2007<sup>3</sup>
- 61.6% of plans have incorporated Roth contributions, compared to 31.1% in 2007<sup>4</sup>

To assess the impact of the PPA on defined contribution plans over the past decade, as well as a look at some of the act’s shortcomings and future challenges, we assembled a diverse panel of experts. Following are some of their insights and suggestions for improvement.

**“PPA went a long way in enabling plan sponsors to make it easier for employees in terms of participating in the plan, contributing to it, and having a suitable investment program.”**

<sup>1</sup>Callan 2016 Defined Contribution Trends

<sup>2</sup>The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2013

<sup>3</sup>Callan 2016 Defined Contribution Trends

<sup>4</sup>Ibid

**Q** ■ What was the environment at the time that led to the changes to defined contribution plans implemented in the PPA?

**Rich Whitney:** The way we started out in the '80s was very well-intentioned, but not that effective. The model at that time was to educate people about asset allocation and the individual investment options offered in the plan, and hope they could build an appropriate asset allocation strategy mostly on their own. As it turned out, that's just a very hard thing for individuals to do. Very few have the interest, patience or knowledge to do that on their own.

Target date or retirement funds, which started in the mid '90s, offered a better alternative for most participants and a lot of plan sponsors added target date funds as an option on their platform. Now, they might not have been defaulting people into those options, but they offered them as choices. PPA enabled them to default people into the age-appropriate target date fund, and that was a key thrust in the industry.

In our case, we had the product that was well-designed, performing well and incorporated some of our best strategies in terms of the underlying portfolios.

**Margaret Raymond:** If you think about the big picture, PPA was an act where Congress recognized the world was shifting from DB to DC. In a world where people are responsible for their own retirement success, which is the DC plan, the individuals bear the outcome of their investment decisions. PPA went a long way in enabling plan sponsors to make it easier for employees in terms of participating in the plan, contributing to it, and having a suitable investment program.

**Q** ■ What was the importance of enacting the PPA for retirement plan providers and participants?

**Judith Ward:** With the passage of PPA and auto enrollment we solved through plan design one of the most challenging issues overnight. Participation rates now are at an all-time high because of the auto-enrollment feature. 61% of our eligible plans use auto enrollment (up from 17% in 2005) and 82% use auto increase (up from 12% in 2005).<sup>5</sup> And, more participants are being enrolled in an age-appropriate asset allocation vehicle from Day One.

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### PPA Exceeds Regulators Estimates

The Department of Labor issued the Final Rule on Default Investment Alternatives Under Participant Directed Individual Account Plans. It read, in part:

“The Department estimates that this regulation will increase overall 401(k) participation rates from 73 percent to between 77 percent and 80 percent.”<sup>6</sup>

By the end of 2014, participation rates exceeded 87% across the industry.<sup>7</sup>

**Whitney:** What PPA did was it really codified that notion of a legal safe harbor for employers who wanted to automatically default an investor into an appropriate diversified asset allocation portfolio.

As long as an employer selects as a default option an investment that has certain characteristics—primarily that it's a diversified, professionally managed portfolio—and the requirements of the QDIA regulation are otherwise satisfied, then they're protected from liability if that choice has negative outcomes from an investment perspective.

### OUR ROUNDTABLE



Aimee DeCamillo  
*Vice President and Head of T. Rowe Price Retirement Plan Services*

- 19 years of industry experience
- 6 Years with T. Rowe Price

Aimee DeCamillo is the head of Retirement Plan Services. She is also a vice president of T. Rowe Price Group, Inc. Prior to assuming her current position in 2014, she was head of Product and Marketing in Retirement Plan Services for T. Rowe Price.



Keith Lewis  
*Head of the Americas for Global Investment Services*

- 37 years of industry experience
- 29 years with T. Rowe Price

Keith Lewis is the head of Global Investment Services for the Americas for the Global Investment Services division of T. Rowe Price, the organization responsible for the firm's global institutional and ex-U.S. intermediary businesses.



Margaret Raymond, Esq.  
*Managing Counsel*

- 25 years of industry experience
- 4 years with T. Rowe Price

Margaret Raymond is a vice president of T. Rowe Price Group, Inc., and T. Rowe Price Associates, Inc. Margaret is a managing counsel, focusing on legal matters relating to retirement savings, including ERISA fiduciary principles and other retirement plan administration topics.

<sup>5</sup> T. Rowe Price Retirement Plan Services, as of 12/31/15

<sup>6</sup> Department of Labor, 29 CFR Part 2550, October 27, 2007

<sup>7</sup> 58th annual PSCA Survey, 2015

**FIGURE 1: Excerpt from Department of Labor Final Rule<sup>8</sup>**

October 24, 2007

“The Department expects and intends that this regulation, together with the automatic enrollment provisions of the Pension Protection Act, will promote wider implementation of automatic enrollment programs. The regulation will help alleviate fiduciary concerns that might otherwise discourage implementation of automatic enrollment programs.”

**Q. How have participants benefited from the changes in the PPA?**

**Keith Lewis:** I think the fact that target dates were sanctioned as the QDIA made the plans more robust in terms of improved outcomes for participants. At that point in time, we were still very much in the accumulation mode versus what we’re entering now which is more of a decumulation mode when you think about the retirement of the baby boomers. So I absolutely think target dates were in the right place at the right time and met a need for a demographic tidal wave as well.

**Whitney:** We find that when investors are in target date funds, there tends to be less panic selling under market stress. If you look at the balances and the investment profile of investors who are not using target date funds inside of 401(k)s, they tend not to be as well-diversified and not as sound from an asset allocation perspective.

**Q. Do you think that plan sponsors have taken all of the necessary actions to help the act achieve its goals?**

**Stuart Ritter:** PPA did an excellent job of helping to solve the investment issue in the context of automatic enrollment.

It also made permanent a law that allowed for Roth 401(k) contributions that didn’t exist for higher income people who weren’t able to use the Roth IRA. It created an opportunity for improving deferral rates.

I would say we’re still waiting to take full advantage of the opportunity that PPA created. The real missed opportunity here is how people have implemented what PPA allowed them to do.

Let me use an analogy. It’s as if people were suffering from infections and in 2006 we discovered antibiotics [auto enrollment]. What we did with this discovery is say, “OK, we’re only going to give antibiotics to new patients [new employees] with the infection and when we give them antibiotics [auto-enroll them] were going to give them a dose that’s so low [a 3% deferral rate] that it doesn’t do enough to completely heal them.”

**FIGURE 2: Automatic Enrollment Plans and Default Deferral Rates<sup>9</sup>**

As of 12/31/15

Default Deferral %	% of Total
1%	2.9%
2	5.4
3	38.0
4	12.6
5	11.4
6	28.6
7	0.3
8	0.9

**FIGURE 3: Automatic Increase Plans**

As of 12/31/15

Rate of Increase	% of Total
1%	74.1%
2	25.9

**OUR ROUNDTABLE**



Stuart Ritter CFP®  
Senior Financial Planner

- 23 years of industry experience
  - 18 years with T. Rowe Price
- Stuart Ritter is a senior financial planner and vice president of T. Rowe Price Associates. He provides guidance on personal finance and retirement-related issues.



Judith Ward CFP®  
Senior Financial Planner

- 32 years of industry experience
  - 32 years with T. Rowe Price
- Judith Ward is a senior financial planner and vice president of T. Rowe Price Associates. She provides guidance on personal finance and retirement-related issues.



Rich Whitney  
Co-head of Asset Allocation

- 31 years of industry experience
  - 30 years with T. Rowe Price
- Rich Whitney is a vice president of T. Rowe Price Group, Inc. He is the co-head of Asset Allocation, overseeing a team of investment professionals dedicated to a broad set of strategies, including target date and other diversified multi-asset portfolios.

<sup>8</sup>Federal Register, Vol. 72, No. 205, Wednesday, October 24, 2007

<sup>9</sup>Based on the client base of T. Rowe Price Retirement Plan Services plans, December 31, 2015.

The doctor's role is to give people who have infections an adequate dosage of the antibiotic. I would put plan sponsors in the role of the physician.

So, PPA kind of created the solution. But it was still incumbent upon the folks making plan design decisions to take advantage of that opportunity. That hasn't been done as effectively.

**Raymond:** It's a fragile balance. We've got to have employers willing to provide some benefits, and workers demanding them, and yet employers need to have economically viable businesses, so those interests need to be realistically balanced.

So, we want to bring forward all these ideas which minimize employers' risks and their cost and the friction of doing the right thing for their employees if the company can afford it. If you think about it, that's an additional burden on an employer and I don't want to mandate that.

### **Q** Where did PPA fall short, or not go far enough? What are some of the challenges ahead?

**Ward:** I think where the PPA falls short is in deferral rates. We have auto enrollment at a very low deferral rate and we find that when people choose their own deferral rate they choose often one much higher. It solved part of the inertia problem about not knowing what to do, but these low deferral rates are problematic.

**Aimee DeCamillo:** I agree that one of the biggest challenges after PPA continues to be getting participants to contribute at higher automatic deferral rates. Guidance prior to PPA used three percent as an example of an acceptable deferral rate. Similarly, the PPA automatic enrollment safe harbor starts at three percent, which plan sponsors have embraced as a best practice. Three percent is not enough, and we have encouraged Treasury to continue to emphasize that higher deferral rates are also acceptable.

While clearly PPA helped those who might not have saved, it actually has been a headwind for the millennial generation in that they're stuck at 3% and they would have potentially saved more. Looking at our own data, 38% of plans still default people in at a 3% deferral, compared to 28.6% who auto-enroll at 6%. You could actually make the argument that it has actually hurt some folks in terms of that inertia. If you don't have an employer that is auto increasing the deferral rate, that's a real problem.

**Whitney:** 401(k)s, which started in the mid '70s, weren't really designed originally as the primary retirement savings vehicle. But 401(k)s have transformed into a primary savings vehicle for most individuals now.

We're only 40 years into this, and the emphasis on individuals saving for their own retirement wasn't quite as great at the outset. More people were covered by defined benefit pension plans and had less responsibility for their own savings.

We're still pretty early in that process of asking individuals to take responsibility for their own retirement, and I think target date funds have encouraged better behavior on the part of participants. They've made it easier for people to invest in a really sensible portfolio, but people need to be saving more if they hope to replace enough of their income in retirement. Someone saving 3% of their salary is not going to be able to replace their salary when they retire, even if they have a really generous company match. You probably need to be looking at saving 15% or more of your earnings to really generate an adequate replacement income in retirement. There's still work to be done there.

If you have \$50,000 saved in your 401(k), there's really no strategy that's going to take that balance and turn it into a decent income stream in retirement.

**Raymond:** One of the big looming challenges is the decumulation phase when people start retiring and drawing

down these assets. Most financial services firms thought if you're not in the accumulation phase, we'll handle you on a transaction basis. Well, a transactional relationship with an aging person is not a sustainable model. If you believe all the research around people living longer in a time of their lives when they're actually not wanting to engage on a transaction-by-transaction basis, there is a huge opportunity to service that population. I think the financial services industry generally and T. Rowe Price would be well-positioned to do this and ought to be focusing on that.

**Lewis:** As I think about the accumulation phase, I think the guidance has been fairly ample in terms of auto features and accumulation-related QDIAs. However, many plan sponsors have taken a wait-and-see approach to retirement income products, like annuities, as they weigh the responsibility required to carry these products.

I think it's easier to develop a common solution during the accumulation phase. It's more difficult to develop a common solution during the retirement income phase. People's circumstances are different, and by definition, retirement income can be driven by more factors than simply in-plan assets.

People have different expectations and desires for retirement, so you're trying to solve for something that is much more complex and much more idiosyncratic down to the individual level. While guidance would help, the actual solve is far more complex than the accumulation solve.

**DeCamillo:** I think there's consensus with clients and across the industry that plan design is the strongest way to drive savings up. The foundation for any retirement success is going to be around plan design. In the early years, post-PPA, we thought plan design was it. In the last five years, we've really shifted the view to say it can't just be plan design. Plan design is the foundation, but you have to have some level of engagement throughout the life cycle particularly at

“If you have \$50,000 saved in your 401(k), there’s really no strategy that’s going to take that balance and turn it into a decent income stream in retirement.”

the critical juncture of transitioning into retirement. Pre-PPA it was enrollment meetings, cafeteria seminars, and posters hanging around the workplace. Education has become more targeted, more personalized, more contextualized.

**Q** ■ Did the PPA achieve what it set out to do?

**Raymond:** I don’t think you can underestimate what happened with PPA in terms of improving retirement outcomes. The key issue was the ability to do auto enrollment. The safe harbor for the auto enrollment was just a tremendous lift not just for the plan sponsor but the industry as

well. The reason really is that it gave the legal comfort where people had unsuccessfully tried to go down that path before.

**Lewis:** PPA clearly hasn’t solved the retirement crisis in the U.S. It can’t address the fact that the number one driver of retirement success is how much money goes into the plan both from the employee and the employer. Also, you’ve got to start saving early. I think you’ve seen improved saving rates in DC plans, you’ve seen improved participation and growing account balances despite the financial crisis. But, we still have a fundamental retirement challenge here in the U.S.

**DeCamillo:** If we were going to do anything to help Americans be financially prepared for retirement, it was getting over the hump around auto-enrollment and the perspective of the ‘90s that offering a broad range of funds on the menu was a good thing. We needed to figure out how to cut through that clutter and put people in the most optimal path to achieve retirement. The PPA charted a path to do that, so we’re far better off today than before the act was passed.

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