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In-depth analysis and insights to inform your decision-making.

The PPA, 10 Years In.
A RETIREMENT REVOLUTION READY FOR EVOLUTION.

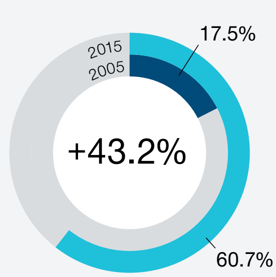
The Pension Protection Act (PPA) of 2006 is one of the most significant legislative developments in the modern age of retirement policy. Enacted in 2006, the PPA enabled automatic enrollment features, raised contribution limits, and provided a safe harbor for default investment selections whose combined effect has dramatically increased plan participation rates and put millions of American workers on a path to better retirement outcomes.

A recent survey by Callan Associates[1] found that 67% of plan sponsors felt that the PPA was beneficial to their defined contribution (DC) plans. Plan sponsors cited several ways in which the act has impacted workers' retirement goals, including: the safe harbor for qualified default investment alternatives (QDIAs), making permanent provisions of the Economic Growth Tax Relief Reconciliation Act of 2001 (e.g., higher contribution limits and Roth contributions), and providing safe harbors for offering auto-enrollment.

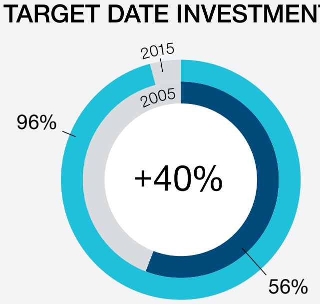
Since the PPA's enactment in 2006, T. Rowe Price has observed dramatic growth in the implementation of automatic features among the retirement plans that it administers in these major areas:

- Auto-enrollment: Of retirement plans that outsource deferrals to T. Rowe Price, more than half have embraced auto-enrollment. In 2005, only 17.5% of our plans used auto-enrollment. That has grown to 60.7% as of year-end 2015.[2]
- Default investments: Auto-enrollment into target date vehicles as the default investment have increased from 56% to 96%.[3]

AUTO-ENROLLMENT[2]

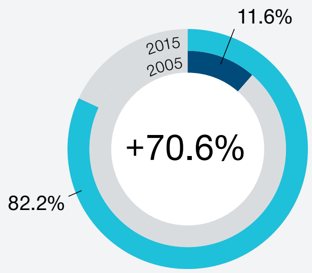


AUTO ENROLLMENT INTO TARGET DATE INVESTMENT[3]

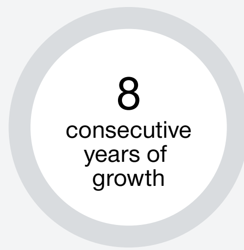


[1] Callan, DC Spot Survey, June 2016.
[2] T. Rowe Price Retirement Plan Services, based on active 401(k) plans that outsource deferrals to T. Rowe Price only, 12/31/2005.
[3] Ibid.

AUTO-INCREASE[4]



ROTH CONTRIBUTIONS[5]



- Auto-increase: Plans using auto-increase have grown from 11.6% to 82.2%.[4]
- Roth contributions: Now offered in 50% of plans, up seven percentage points from 2014. As a result, participants making Roth contributions have increased for the eighth consecutive year.[5]

While there has been significant growth in these areas, there are still many opportunities ahead to improve retirement outcomes.

“How do we get targeted at the right point in time to make sure that you’re starting them out on the right path?” says Aimee DeCamillo, vice president and head of T. Rowe Price Retirement Plan Services. “I think there’s an opportunity for a next generation of auto-services to get more targeted. So, for example, imagine where a plan sponsor takes a more innovative approach and automatically enrolls employees under age 40 into a QDIA with Roth deferrals.”

The evolving landscape since the PPA has led to shifts in both plan sponsor and participant behavior.

PLAN SPONSORS INTRODUCING HIGHER DEFERRAL RATES

While the PPA allowed plan sponsors’ auto-enrollment, and the industry standard seemed to gravitate toward plan sponsors implementing a 3% default deferral rate, plan sponsors are changing the industry standard by increasing auto-enrollment from the typical 3%, resulting in a better chance for positive retirement outcomes.

There has been a 28% increase since 2014 of plan sponsors enrolling at a 6% deferral rate or more (23.6% to 30.2%) in plans where T. Rowe Price is the recordkeeper. While 3% remains the most utilized deferral rate, the shift to 6% indicates that sponsors realize that a 3% deferral is not going to be enough for their participants to save enough for retirement.[6]

“This trend is important because participants take cues from their employers. It’s reasonable to think participants interpret the employer deferral rate as a sufficient savings rate to achieve a successful retirement outcome,” says Lorie Latham, T. Rowe Price Senior DC Strategist. “Low deferral rates leave participants at risk of woefully under-saving. Sponsors have an opportunity to address this issue, and our data reveals movement in a better direction.”

This trend can yield positive results. According to the T. Rowe Price Retirement Saving and Spending Study, both millennials and Gen Xers contribute, on average, 8% of their pay to a 401(k) plan. For those that were auto-enrolled, about 50% of both generations also agreed (completely or somewhat) that they wish they had been enrolled at a higher contribution rate.[7]

PARTICIPANTS GET STUCK AT DEFAULT RATE

Employers still face challenges with participant inertia on several levels. First, participation rates continue to be strongly tied to the adoption of auto-enrollment. Plans with an auto-enrollment feature have a participation rate of 88%. Plans that don’t offer auto-enrollment only have a participation rate of just 48%.[8]

Only 38% of participants increased their deferral rate in 2015. Assuming most of these participants were enrolled at 3%—the example deferral rate used in U.S. Treasury Department guidance and the PPA safe harbor—plan sponsors should be concerned about retirement readiness for their employees as well as workforce planning issues.[9]

Auto-increase will automatically raise deferral rates annually toward the suggested 15% savings rate (including employer match). Results show that most participants will not opt out of auto-increase features. In fact, plans that offer auto-increase on an opt-out basis have a six times higher adoption rate compared with plans that use opt-in features.[10]

[4] Ibid.
[5] T. Rowe Price Reference Point, 2016.
[6] Ibid.
[7] T. Rowe Price Retirement Saving and Spending Study, 2015.
[8] T. Rowe Price Reference Point, 2016.
[9] Ibid.
[10] Ibid.

Since plan participants have demonstrated a great degree of inertia in being receptive to default options, there is an opportunity for employers to slowly nudge participants toward a higher savings rate, as high as 15%, over time.

"Participants think their company has their best interest at heart, so they almost see whatever the company is doing as 'this is what is best for me,'" says Senior Financial Planner Judith Ward, CFP®. "We've seen with these auto-features that many participants stick with the default settings of their plan. If plan sponsors implement auto-increase on an opt-out basis, that can help move participants to a higher savings rate over time."

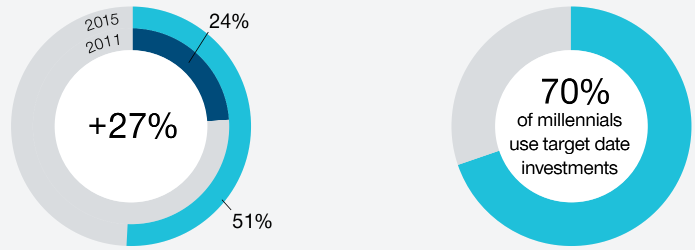
But on a more discouraging note, nearly one-third (31% of participants) are not contributing anything to their retirement plan, putting their retirement in jeopardy.[11]

Financial wellness programs could be a way to address financial well-being for participants so their everyday expenses are not a barrier to saving for retirement. Half of plan participants said they were absolutely certain or very likely to increase their 401(k) contributions if they had less debt and 31% said they would save more for retirement if they had an emergency fund in place.[12]

While some financial wellness programs focus on short-term money issues like budgeting and debt, there can be some long-term benefits around retirement savings.

According to SmartDollar®, 39% of participants in their financial wellness programs are saving 15% of their salary for retirement after two years.[13]

TARGET DATE INVESTMENT USAGE[15,17]



"Those are powerful statistics as they reveal that those participants who are engaged and informed in a more holistic way about their financial matters are making decisions that will lead to better outcomes," Latham says. "Our industry has an opportunity to build on this to encourage behaviors, which will improve the overall retirement readiness of participants."

TARGET DATE INVESTMENTS EMERGE AS INVESTMENT LEADER IN PLANS

The PPA paved the way for target date investments to be utilized as a QDIA in 2006. In 2006, 32% of 401(k) plans offered target date investments. This rose to 73% of plans by 2013.[14]

Less than two years after the PPA was in place, the global financial crisis sent markets reeling, and the industry seemed to second guess whether target date investments were still a good default option.

"At that time, we had to respond to the criticism that 401(k) plans were broken and target date investments didn't work," Ward says. "So, while target date investments did lose value, much like most investments during that time, we found that the majority of our participants stayed in the investment and as a result, were able to benefit when the market rebounded."

In the years following the PPA's enactment, there has been a larger target date investment presence in T. Rowe Price's retirement plans:

- Target date vehicles surpassed stock vehicles as the primary holder of assets in 2015.
- 93% of T. Rowe Price-administered plans offer a target date investment solution.
- Participants that are 100% invested in target date investments have more than doubled in the past four years, up from 24% in 2011 to 51% in 2015.[15]

Target date investments have also slowly helped rectify extreme asset allocation. In 2005, 33% of participants in their 60s had over 80% of their retirement savings in stocks, but that number dropped to 25% of participants in their 60s in 2013. In 2005, 20% of participants in their 20s had no money in stocks. By 2013, that figure was cut in half.[16] The net result of the migration to target date funds is that more individuals invested in well-diversified portfolios.

[11] Ibid.
[12] T. Rowe Price Retirement Saving and Spending Study, 2015.
[13] SmartDollar, 2015.
[14] BrightScope and Investment Company Institute. 2015. *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2013*. San Diego, CA: BrightScope and Washington, DC: Investment Company Institute. Available at ici.org/pdf/ppr_15_dcplan_profile_401k.pdf.
[15] T. Rowe Price Retirement Plan Services, based on active 401(k) plans that outsource deferrals to T. Rowe Price only, 12/31/2005.
[16] T. Rowe Price analysis of ICI/EBRI research, 2013 data.
[17] T. Rowe Price Reference Point, 2016.

Our next objective as an industry must be a successful pivot toward thinking about defined contribution plans as "retirement" plans instead of as "savings" plans.

While many plans have auto-enrolled new, and possibly younger, employees into a target date option, they may not have considered a one-time reenrollment into a target date QDIA. Currently, 70% of millennials aged 20–29 use target date investments—the largest of any group. The adoption of target date vehicles as primary investments is considerably lower among baby boomers aged 60–69 (29%).[17]

T. Rowe Price also found that its participants who are 100% invested in target date vehicles are 10 times less likely to make exchanges regardless of market climate, participant age, or whether or not the investment was chosen or was the default option.[18]

Plan sponsors may want to review their employee demographics to determine the extent to which participants may benefit from reenrollment or other actions, such as enhanced and targeted education in order to help improve asset allocation. As these practices are adopted, this should result in fewer outliers.

When nonparticipants in the plan who have previously opted out are automatically reenrolled back into the plan, 84% remain enrolled, and 98% of these participants stayed at the default rate.[19]

When plans implement a QDIA reset, moving participants' existing balances and future contributions into a diversified investment option, 71% of assets remained in the QDIA after 18 months, and 86% of participants kept some of their investments in the default option.[20]

Plan participants should be provided ample opportunity to opt out and make active investment elections.

LOOKING FORWARD: RETIREMENT INCOME SOLUTIONS

The PPA was squarely focused on opportunities to improve retirement savings, and the outcome has been largely successful. The legislation was critical in making it easier for Americans to accumulate savings while contributing to an employer plan at a predetermined deferral rate.

"Our next objective as an industry must be a successful pivot toward thinking about defined contribution plans as 'retirement' plans instead of as 'savings' plans," says Latham. "While we should keep pushing on improving savings rates, it's equally important that we consider the whole life cycle of retirement assets and move toward identifying solutions that further address longevity risk and help participants draw down their DC assets successfully."

The landscape has shifted from defined benefit to defined contribution as the key retirement vehicle, resulting in the need for income-generating vehicles to emerge in the DC space. While the PPA facilitated employers to auto-enroll their employees, there isn't a simple way to "auto-retire" participants when they are ready to leave the workforce and draw down their savings.

A 2016 Willis Towers Watson survey cited that the top two reasons sponsors may offer or consider offering lifetime income solutions are:

- The desire to help participants convert accumulated DC plan balances to lifetime income (71%).
- The shift from DB to DC as the primary retirement vehicle, leaving it up to future retirees to manage their own retirement assets (50%).[21]

Clearly, the recognition of need is there; however, most plan sponsors still have concerns about implementing in-plan income solutions. Eighty-two percent of workers surveyed by Aon Hewitt cited that the most common barrier as waiting for the market to develop more.[22]

Plan sponsors are reluctant to be early adopters based on the products in the marketplace, as well as on concern over fiduciary risk, cost, and the complexity of the range of offerings. In addition, some plans still have active or recently frozen defined benefit plans, which minimizes their concerns or makes the need seem less imminent.

In a recent study by T. Rowe Price and Oliver Wyman, respondents don't view a retirement income solution as a priority right now. Due to the lack of proven solutions and a more protective safe harbor for annuity selection, the majority of plan sponsors are currently focused on lowering costs and increasing participant contributions.[23]

Plan sponsors expect a solution to take one or two years to implement; and

[18] T. Rowe Price Investor Behavior Study, May 2016.
[19] T. Rowe Price Retirement Plan Services, based on active 401(k) plans that outsource deferrals to T. Rowe Price only, 12/31/2015.
[20] Ibid.
[21] 2016 Willis Towers Watson Lifetime Income Solutions Survey.
[22] Aon Hewitt, "Hot Topics in Retirement and Financial Well-Being," 2016.
[23] Oliver Wyman, "*Retirement Income Solutions Study*," May 2016.

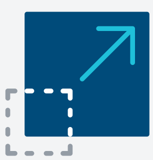
if a more protective safe harbor were available, they could accelerate. Also, plan sponsors cite a lack of demand from participants, mainly due to low awareness, operational complexities, costs, and little competitive pressure.[24]

The format of these retirement income solutions also remains a challenge. Should it be one-size-fits-all, or are multiple solutions needed to address a range of needs?[25]

"We believe that our DC clients will require a variety of capabilities to address their employees' diverse retirement income needs over the next decade. Clearly, the product offerings in the marketplace have not gone far enough, and it's likely that a suite of offerings will be needed," says Sebastien Page, co-head of T. Rowe Price's Asset Allocation group. "Whereas target date investments provided a single solution for the accumulation phase, we believe a combination of solutions will have to be developed for the withdrawal phase. Innovation will need to come from asset managers, insurers, and service providers to solve the investment and engagement requirements of diverse employee populations."

KEY TAKEAWAYS

In looking at the maturation of retirement plans and features over the past 10 years, we believe there is still room for evolution in plan design.



- Continue to emphasize the importance of savings and how auto-services can potentially improve outcomes for participants.
- Enhance plan design, implementing auto-increase on an opt-out basis with the goal of accelerating retirement savings.
- Continue to explore the role of retirement income solutions to address diverse participant needs in retirement.

[24] Ibid.
[25] Ibid.

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To learn more, please visit troweprice.com.

Important Information

The principal value of target date funds is not guaranteed at any time, including at or after the target date, which is the approximate date when investors plan to retire. These funds typically invest in a broad range of underlying mutual funds that include stocks, bonds, and short-term investments and are subject to the risks of different areas of the market. In addition, the objectives of target date funds typically change over time to become more conservative.

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. The views contained herein are as of August 2016 and may have changed since that time.

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