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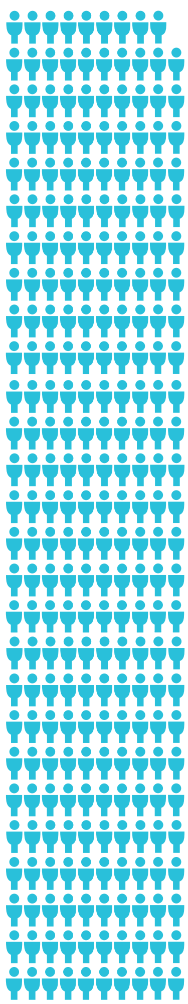
How Plan Sponsors of Larger 401(k) Plans Are Aiming for Retirement Preparedness: **A Human Resources Perspective**



269

executives surveyed

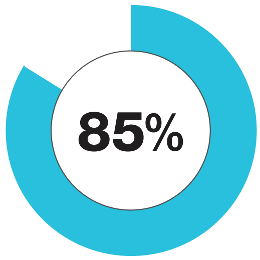
MORE THAN TEN YEARS after the Pension Protection Act (PPA) was signed into law, along with the subsequent rules from the Department of Labor,[1] significant progress has been made with making it easier for employees to participate in 401(k) plans, to contribute to them, and to have suitable investment programs. While the PPA has dramatically impacted participant behavior, the ultimate quest to improve retirement outcomes for 401(k) participants is continuing more than ten years later.

In late 2016, we conducted a study of plan sponsors, *Human Resources Perspectives: Study of Larger 401(k) Plans*, to understand the attitudes of sponsors and their intentions to make changes to their plans in the next two years. Specifically, we covered activity related to the two central provisions of the PPA, i.e., automatic enrollment programs and qualified default investment alternatives (QDIAs) and, especially, target date funds. We also asked questions to examine other trends and innovations in 401(k) plans, such as usage of various automatic plan features and stretch matching contributions, to name a few.

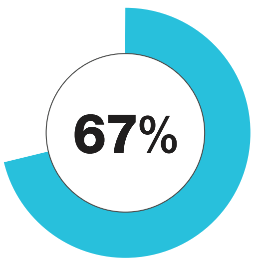
Our study provides a human resources and benefits professionals' viewpoint by examining sponsors with 401(k) plan assets of $100 million to over $1 billion. It is based on a nationally representative sample of 269 executives (in human resources and benefits functions) that was fielded from September 8, 2016, to November 15, 2016. The majority of the interviews were conducted by phone, based on Form 5500 sampling frame, and the balance was completed via online surveys.[2] The findings reveal the mind-set of plan sponsors in late 2016 with respect to the 401(k) plans offered to their employees.

[1] Federal Register, Vol. 72, No. 205, Wednesday, October 24, 2007.

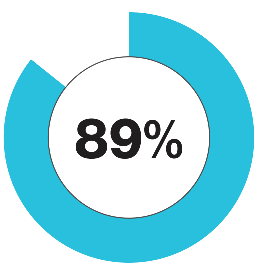
[2] Representative national study based on HR, employee benefits, and plan administration professionals who are responsible for selecting, evaluating, or monitoring providers, services, and investments for their organizations 401(k) plan. N = 269 completes of which 169 were phone interviews and 100 were online surveys. Oversample of $500M+ plans weighted back to naturally occurring proportions.



of plan sponsors whose major goal is to help employees save for a financially secure retirement.



agree a great deal that they have a responsibility to help participants achieve retirement preparedness.



provide a matching contribution to participants.

Large Plan Sponsors Are Committed to the Retirement Security of Participants

The study gives us a picture of plan sponsors who are taking responsibility for the financial security in retirement of their participants. Not only does this responsibility encompass the in-plan years for active participants, but for a notable proportion it also entails helping retired participants manage income.

- **Eighty-five percent** of plan sponsors indicate that helping employees save for a financially secure retirement is a major goal (top box finding) of their 401(k) plans.
- Almost **70%** (67%) agree a great deal, that they have a responsibility to help participants achieve retirement preparedness. Another 32% percent agree somewhat that they have this responsibility.
- **Eighty-nine percent** provide a matching contribution to participants.
  - Seventy-seven percent are committed (will take steps or already do) to maintaining the match in light of other benefit expenses, in 2017.

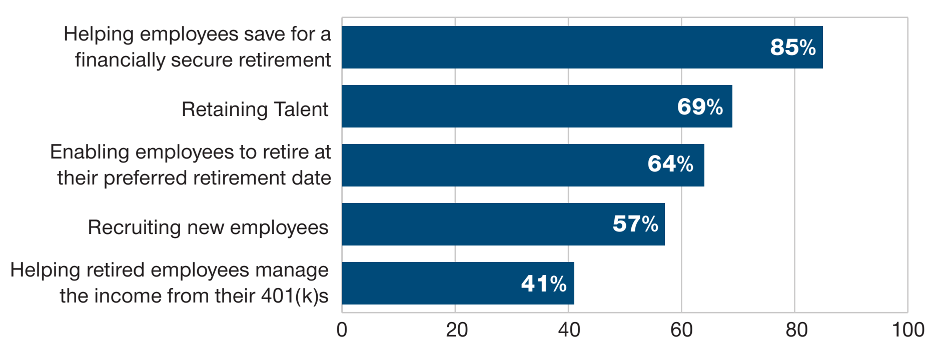
Retirement income findings

- Helping **retired** employees manage the income from their 401(k)s is a major plan goal for four of ten plan sponsors.
- Fifty-two percent offer terminated employees periodic withdrawals and another 4% intend to add this feature in the next 2 years.

GOALS OF 401(k) RETIREMENT PLAN BENEFIT

As of 2016. Base: total interviews. "Major Goal"

Is (each item) a major strategic goal of your organization's 401(k) retirement plan benefit, a main goal or not a strategic goal at all?

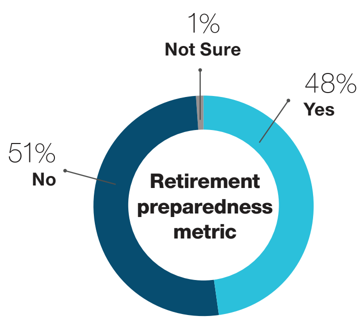


> **“Our next objective as an industry must be a successful pivot toward thinking about defined contribution plans as “retirement” plans instead of “savings plans.”**
>
> **— LORIE LATHAM**
> T. Rowe Price Senior DC Strategist

These objectives and actions illustrate a commitment to retirement security that extends beyond employment. In fact, looking at the extent of responsibility for retirement preparedness along with the goal of helping retirees manage income, we see a 401(k) retirement provision that is moving in the direction provided by defined benefit plans. Lorie Latham, T. Rowe Price Senior DC Strategist, considers this to be an important trend.

The third-ranked major plan goal is enabling employees to retire at their preferred retirement date, which was indicated by 64% of sponsors. This finding suggests that sponsors’ commitment to retirement preparedness is not just about the employees. It also supports workforce management goals: productivity, cost management, and career advancement of younger workers.

The study found that plan sponsors are positive about their plan’s recent progress toward retirement preparedness. Almost two-thirds (64%) feel better about 401(k) participants’ retirement preparedness compared with two years ago.

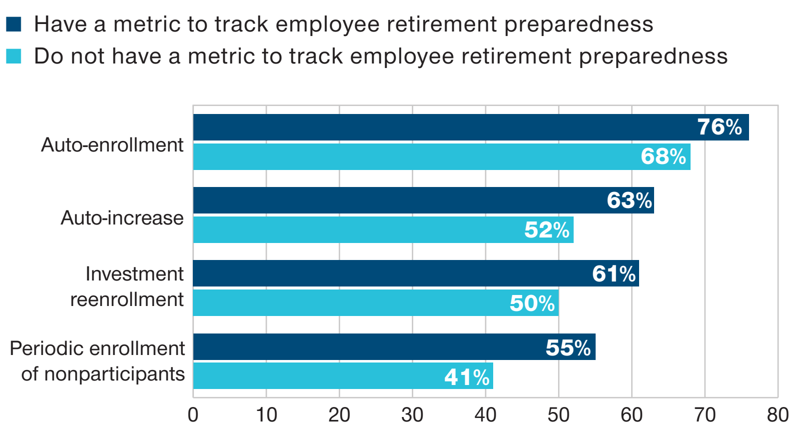


Opportunities and Insights:

Do you have a metric for retirement preparedness?

While the study indicates that most sponsors report progress with retirement preparedness, we did see that having a formal metric correlates with higher usage of more advanced plan design features: automatic enrollment, automatic increase (also referred to as auto-escalation), investment reenrollment, and periodic enrollment of nonparticipants. Almost half (48%) of plan sponsors have a formal ongoing metric to track retirement preparedness of employees.

USAGE OF PROGRAMS



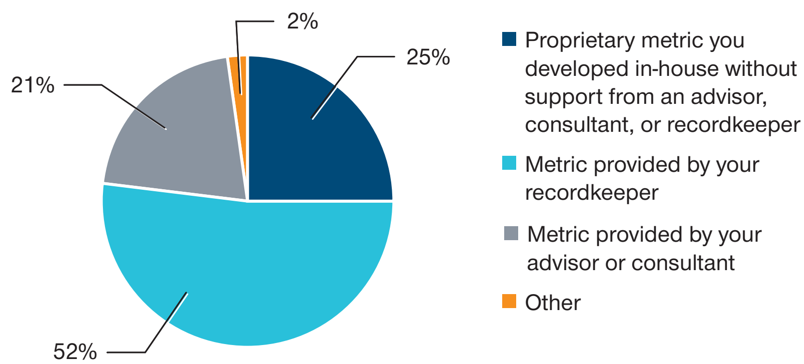
At T. Rowe Price Retirement Plan Services, we can work with clients to develop a set of measurements for their 401(k) plan to gauge retirement preparedness and other aspects of plan health. T. Rowe Price's Plan Health (featured in PlanView Portal) provides plan sponsors with a set of tools, metrics and benchmarks, and more, so that they can assemble a comprehensive Plan Health assessment that is relevant for their 401(k) plan.

If you do not have a formal metric for retirement preparedness, consider asking your plan recordkeeper or full-service provider if they can develop metrics that would be appropriate for your plan. In our study, most sponsors using a metric report that it was provided by their recordkeeper (52%), and consultants/advisors also provided metrics for 21% of sponsors.

METRIC PROVIDER

As of 2016 Base: Have employee preparedness metric (48%)

Is that a....



Automatic Plan Features Are Now Widely Used By Plan Sponsors

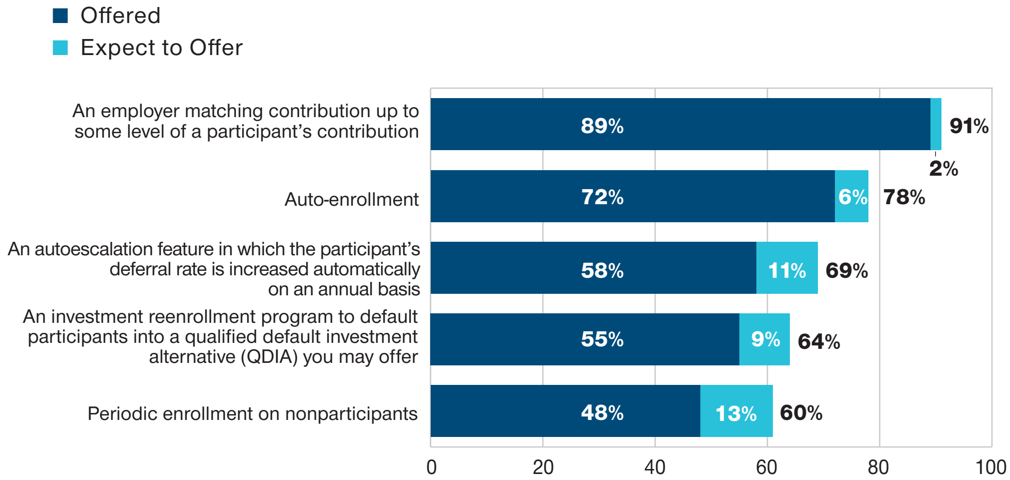
Automatic enrollment is now used by almost three-quarters (72%) of plan sponsors. But the usage of other automatic programs is more varied:

- Far fewer sponsors deploy periodic enrollment of current employees who do not participate (48%).
- Auto-increase is used by 58%, significantly below the 72% auto-enrollment number.

The study found that the average default deferral rate of those who use auto-enrollment, is 4%.[3] The automatic increase feature is an important complementary mechanism to drive savings rates to levels needed for retirement preparedness.

[3] This is phone-based only.

401(k) PLAN FEATURE OFFERED/EXPECT TO OFFER



Opportunities and Insights:

Managing auto-increase programs synergistically with compensation strategy

In multiple areas of the study, it is evident that plan sponsors are aware of the financial fragility of participants.

Among the 58% of sponsors who offer an auto-increase program, almost half indicate that "not being able to afford the increase" is a major reason that participants opt out of the program (47%).

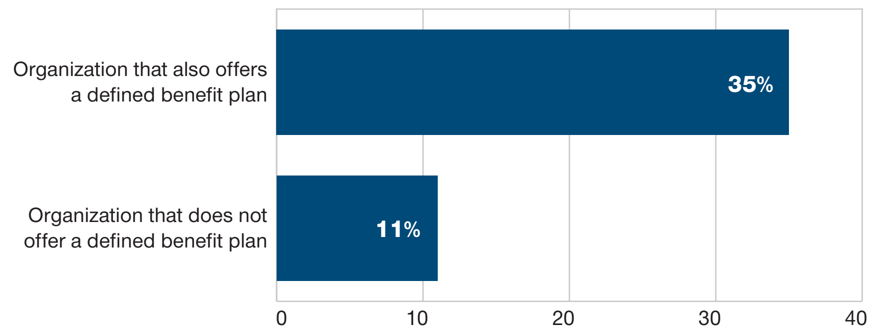
Because of this situation, managing the automatic increase program, specifically the annual rate of increase in tandem with annual compensation increases, would potentially benefit financially challenged participants.

The study shows that 21% of sponsors consciously increase pay by at least as much as the auto-increase percentage. This practice is three-times more common among plan sponsors who also offer a defined benefit plan (35% versus 11%). This likely represents a best practice, and it may be an effective practice to reduce the opt-out rate of auto-increase programs.

MANAGING COMPENSATION VS. AUTO-INCREASE RATE

As of 2016. Base: Have auto-increase (58%). "Consciously increase pay by at least auto-increase amount."

Do you consciously manage your compensation strategy to increase pay by at least as much as your auto-increase amount, or are the two values unrelated?



Please see the white paper[4] from Defined Contribution Institutional Investment Association (DCIIA): *Automatic Features in Defined Contribution Plans: What's in it for Plan Sponsors?*

Opportunities and Insights:

Developing a road map for multiple auto-programs

From a strategic perspective, you may want to consider how multiple automatic programs can work effectively together. The Defined Contribution Institutional Investment Association (DCIIA) advocates for the development of a multi-year plan to strategically utilize multiple automatic features programs.

Matching Contributions Are Offered By Almost 90% of Plan Sponsors

Their commitment to maintaining the matching contribution is impressive: 77% say they intend to maintain the match versus other competing benefits expenses in the next two years.

In 2015, T. Rowe Price conducted a national study of participants saving in 401(k)s, *Retirement Saving and Spending*.[5] In that study, we learned that 86% of participants set their contribution rate to take full or partial advantage of the employer match. This behavior holds true for millennials, of whom 90% indicate that they set their contribution rate to take advantage (full/partial) of the matching contribution.

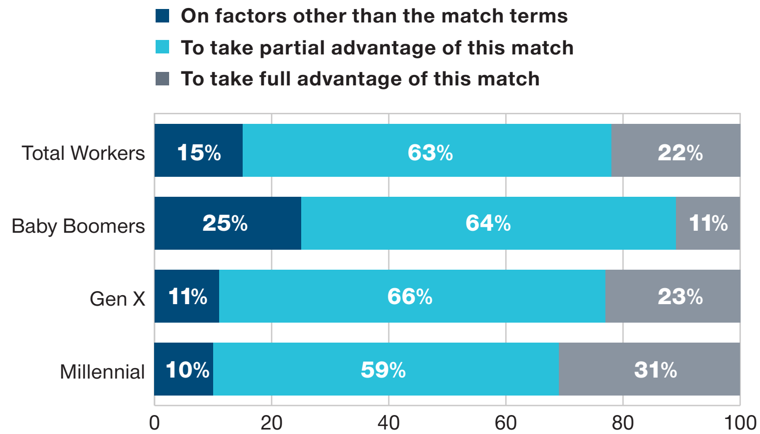
[4] Automatic Plan Features in Defined Contribution Plans: What's in it for Plan Sponsors? July 2016, Defined Contribution Institutional Investment Association (DCIIA).

[5] T. Rowe Price, Retirement Saving and Spending Study, 2015. A representative national study of 3,026 working adults, age 18+, who are contributing to a 401(k) or are eligible to contribute and have a balance of $1,000+. The survey was conducted online by Brightwork Partners LLC, March 4–25, 2015.

INFLUENCE OF MATCH ON CONTRIBUTION

As of 2015. Base: Workers, expecting an employer match (86%).

To what extent is your contribution rate determined by this match?
You set your contribution rate...



Opportunities and Insights:

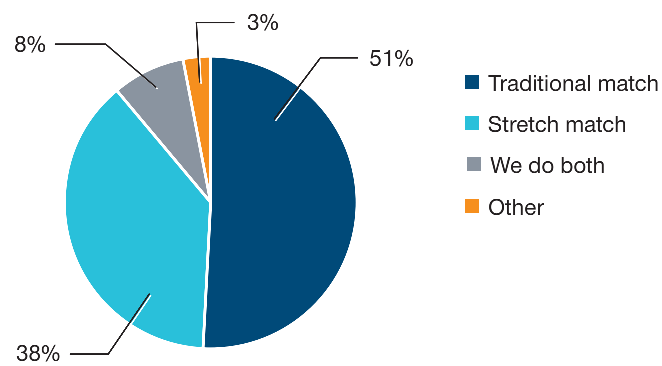
Considering a stretch matching formula

As the employer match significantly influences savings rates, there is an opportunity to drive savings behavior by utilizing a stretch matching formula. The study indicates that the majority of sponsors have a traditional matching formula (51%) and 38% are using a stretch match.

MATCHING FORMULA

As of 2016. Base: Employer offers a match (89%)

Which matching formula more closely resembles your policy: a traditional match which might match $1 for each $1 of contribution up to 3% or a stretch match formula which might match 50 cents for each $1 contribution up to 6%?



When asked why plan sponsors offer a traditional match instead of a stretch match, we learned that sponsors are concerned about the reception from employees (69%) and the financial limitations of participants who might miss out on the match due to the higher contribution requirements (63%). There was also a lack of familiarity about the approach (29%) and uncertainty regarding the cost implications to sponsors (42%).[6]

At T. Rowe Price Retirement Plan Services, we have assisted many plan sponsors with designing a matching formula for their plans. We have a number of case studies that illustrate the potential impact to participant behavior from offering a stretch match. Please contact T. Rowe Price for further information about our consulting services for employer matching formulas.

[6] Very/somewhat closely describes my situation.

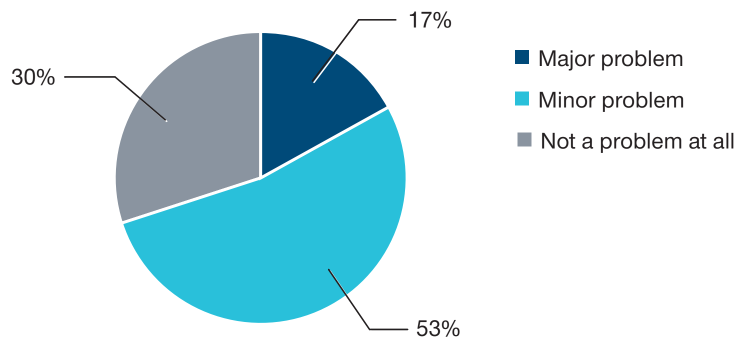
More Than Two-Thirds of Large Plan Sponsors Indicate That Leakage Is a (Major/Minor) Problem

As a counterpoint to positive findings in the study, leakage of plan assets, by virtue of defaults on plan loans, hardship withdrawals, and cash-outs, is a major or minor problem for 70% of plan sponsors.

LEAKAGE

As of 2016. Base: Total interviews

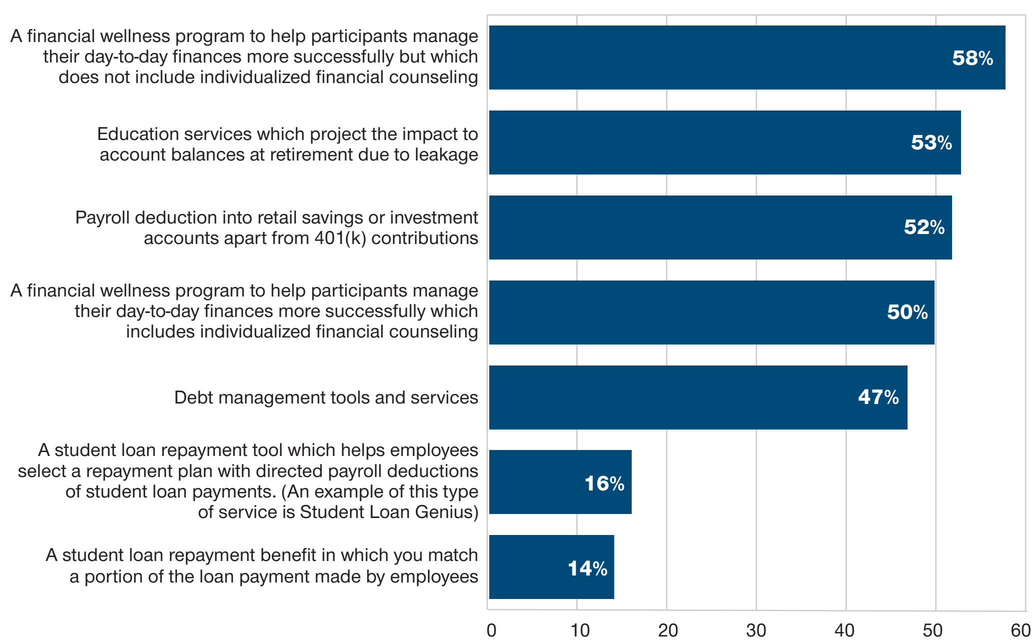
Leakage of retirement plan assets due to defaults on plan loans, hardship withdrawals and cash-outs can reduce the retirement preparedness of participants. To what extent is leakage a problem for your organization's plan, is it:



PROGRAMS OFFERED TO ADDRESS LEAKAGE

As of 2016. Base: Leakage is a major or minor problem (70%)

Some plan sponsors are offering various programs to address leakage. To address this leakage, do you offer (each item), or not?



When asked about programs used specifically to address leakage,[7] 58% offer financial wellness programs (without personal counseling) and 53% report that they use educational programs that project the impact of leakage to account balances at retirement.

At T. Rowe Price Retirement Plan Services, we offer an integrated financial wellness program which can help employees build a strong financial foundation and proactively control their money.

Opportunities and Insights:

Is leakage a problem in your plan?

The leakage finding is a clear indication of the scope of participants with financial challenges. It is encouraging to see that plan sponsors are recognizing the connection of financial wellness and the ability to save for retirement.

While financial wellness programs have been well-received by employees, they are usually positioned as a general employee benefit. There is an opportunity to align financial wellness offerings with the saving objectives of 401(k) plans. For many participants, the workplace savings plan is their only source of savings for their needs. In the absence of a dedicated emergency fund, participants in financial crisis are looking to their retirement plan as the only source of money to address those needs. Plan sponsors need to identify points where an integrated financial wellness benefit can put them in a position of not turning to the retirement account for emergencies, thereby maximizing their savings ability.

SURVEY NOTES: TARGET DATE FUNDS AND INVESTMENTS

A series of questions in the survey address the investment menu of the plans. Because the respondents of this survey are Human Resources and Benefits professionals, the responses represent the HR/ Benefits managers' perspectives of the investment strategy for their plans.[8] T. Rowe Price considers the investment questions as directional information based on the HR and Benefits managers' perceptions of their investment strategy.

Target Date Funds Are Widely Used With High Satisfaction

The dominance of target date funds as the qualified default investment alternative (QDIA) is firmly in place more than ten years after the PPA. The Investment Company Institute (ICI) reports that the percentage of 401(k) participant holding target date funds was 19% in 2006 and reached 41% in 2013.[9] Our survey found that 83% of plan sponsors offer target date funds and, of that group, 88% designate the funds as the qualified default QDIA.

[7] Leakage is defined as defaults on plan loans, hardship withdrawals, and cash outs.

[8] Study sample is HR, employee benefits, and plan administration professionals who are responsible for selecting, evaluating, or monitoring providers, services, and investments for their organizations 401(k) plan.

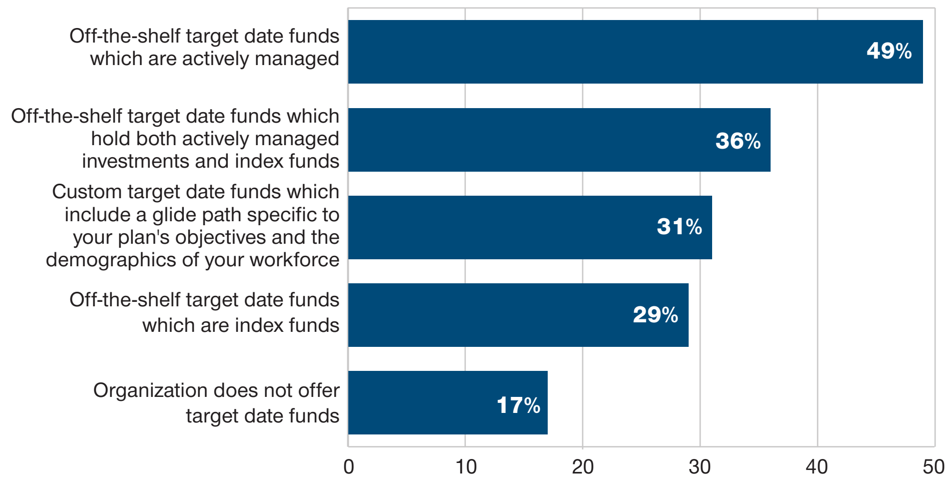
[9] Investment Company Institute (ICI) Retirement Summit, April 8, 2015. Source: Tabulations from EBRI/ICI Participant-Directed Retirement Collection Project, 2013.

Today we have a growing number of types of target date structures being offered by plan sponsors, but the off-the-shelf vehicles continue to be offered by most sponsors.

TARGET DATE FUND TYPES OFFERED

As of 2016. Base: total interviews

Does your organization's 401(k) plan offer (each item) or not?

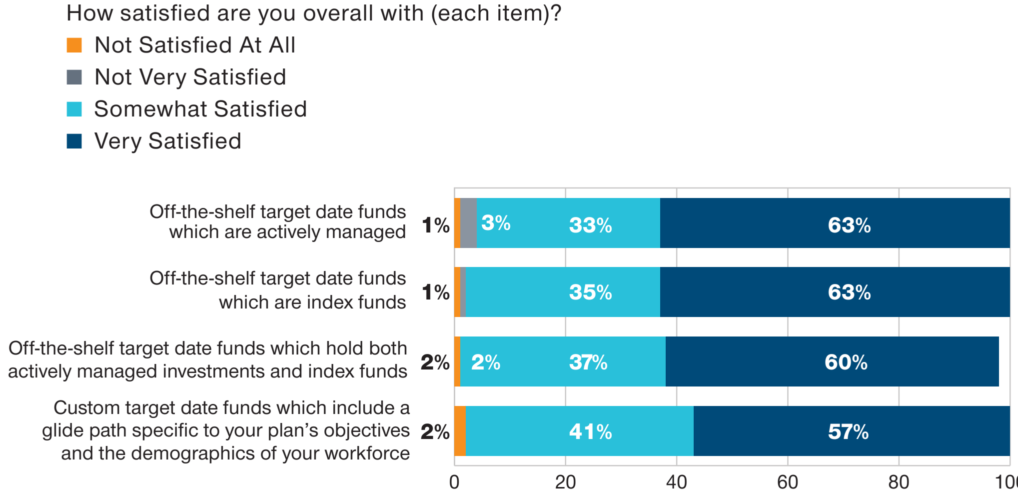


Satisfaction with all types of target date funds is uniformly very high, ranging from 96% to 98% (somewhat and very satisfied). Of note is the proportion that is very satisfied, which ranges from 57% to 63%.

SATISFACTION WITH THIS TYPE OF TARGET DATE FUND

As of 2016. Base: Offers this type of target date funds.

How satisfied are you overall with (each item)?



About half of sponsors offering target date funds report that their funds are proprietary funds managed by their recordkeeper (49%).

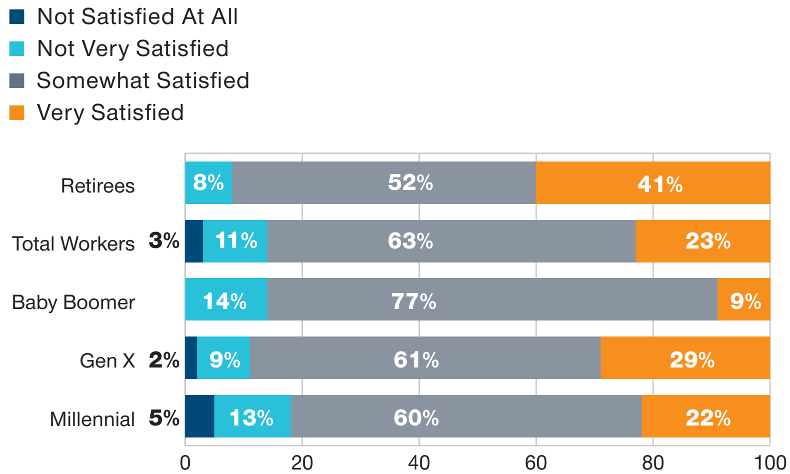
In our national study of 401(k) participants, *Retirement Saving and Spending*,[10] we also found high satisfaction with target date funds, among those participants using the funds, at 86%, somewhat or very satisfied.

This was especially true of Generation X (90% somewhat or very satisfied).

PARTICIPANT WITH THIS TYPE OF TARGET DATE FUND

As of 2015. Base: Offers this type of target date funds. "Somewhat and Very Satisfied."

How satisfied are you overall with (each item)?



Retirement Income Features and Products Are in Place

In line with the plan goal of helping retirees manage income, we found significant usage of retirement income products and services:

- 52% of sponsors provide a periodic withdrawal feature and 4% intend to add the service in the next two years.
- Managed payout funds are offered by 25% of sponsors with 4% planning to offer these products in the next two years. Of note, for those sponsors who also provide a defined benefit plan, 40% offered managed payout funds.

[10] T. Rowe Price, Retirement Saving and Spending Study, 2015. A representative national study of 3,026 working adults, age 18+, who are contributing to a 401(k) or are eligible to contribute and have a balance of $1,000+. The survey was conducted online by Brightwork Partners LLC, March 4–25, 2015.

[11] How interested would you be in a target date fund designated by the year in which a participant expects to retire that includes a managed payout feature to generate a payout stream over time for retirement income? The income stream would be based on a percentage of assets and is not a guaranteed payout.

Other Products of Interest: ESG

In late 2016, the appetite for investment options that are reflective of social values was modest. The study found that 18% of plan sponsors offer ESG (environmental, social, and governance) funds and an additional 9% intend to do so in the next two years, which would put ESG usage at 27%.

In Review: Closing Thoughts

1 Larger 401(k) plan sponsors are committed to their participants' retirement security, and this commitment is demonstrated by their attitudes and actions:

a. 67% agree a great deal that they are responsible for helping participants achieve retirement preparedness, and 32% agree they are somewhat responsible.

2 The 401(k) plan responsibilities now reach beyond employment with 41% of plan sponsors having a major plan goal to help retirees manage income from the 401(k) in retirement.

a. 52% offer terminated participants a periodic withdrawal feature that facilitates using the 401(k) as a long-term retirement plan with income withdrawals.

3 Plan sponsors are optimistic about their plans progress with retirement preparedness:

a. Almost two-thirds (64%) report improvements compared with two years ago.

4 But the financial fragility of participants is evident in multiple areas of this survey:

a. 70% of sponsors indicate that leakage is a major or minor problem for their plans.

b. A key barrier to offering a stretch match contribution is the concern that participants won't be able to afford it (63% of sponsors).

c. Of those whose participants decline or opt out of an automatic increase feature, 47% of sponsors say that not being able to afford the increase is a major reason.

d. 64% name a workforce management goal as a major plan objective, i.e., enabling employees to retire at their preferred date. As almost two-thirds have this goal it suggests that the majority of sponsors face challenges with the timely retirement of employees.

5 Ten years after the PPA, target date funds and automatic features programs are ubiquitous in 401(k)s. And they are so well-received that new product/programs are expected to live up to their standards in terms of automation characteristics. Automatic enrollment has been joined by a series of automatic programs, and the next frontier is likely to be the usage of multiple programs in an optimal combination, sequence and frequency—a strategic road map for automatic programs. We also expect to see more attribution of specific auto-features programs in terms of participant outcomes, which should shed light on which programs to use and what to expect.

6 The off-the-shelf version of target date funds continues to be the standard bearer for the majority of sponsors but custom funds are being used by 31%. In late 2016, almost 50% of plan sponsors with target date funds offered proprietary funds.

7 Full-service providers and recordkeepers are positioned to play a key role for plan sponsors who are advancing retirement readiness via financial wellness programs. Financial wellness programs are now in place for many large plans. But they are most often viewed as a general employee benefit and are not directly tied to objectives within the 401(k) plan.[12] In other words, the financial wellness programs sit alongside the 401(k) but are generally not well integrated. There are areas of innovation that will depend on the leadership of recordkeeping providers:

a. An individual can only sustainability save for retirement if a solid financial foundation is in place. Promoting the availability of financial wellness within the context of retirement savings reaches the participant when they are engaged. The full-service providers and recordkeeping platforms are the likely place for this integration to take place.

b. Financial wellness programs need to address a range of needs that will evolve through their life stages. These programs must effectively engage participants through a variety of channels ranging from tools and applications to personal financial counseling. Full-service providers and recordkeepers are positioned to facilitate the bundling of multi-component programs that can accommodate new offerings as needed.

[12] T. Rowe Price, Plan Sponsor Pulse Survey, April 2016. Sample is 401(k) plan sponsors with $100M to over $1B in plan assets.

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