

Seven Attributes of an Excellent Defined Contribution Plan

*“Excellence is the gradual result
of always striving to do better” - Pat Riley*

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When trying to evaluate key characteristics of a retirement plan, it is common practice in the defined contribution (DC) industry to ask, “How does our plan compare to other plans?” So, plan sponsors and their advisors benchmark their plans versus industry averages to see how their plans measure up. But, is that what we should be striving for? Should being average, or slightly better, be our goal (especially in an industry that most observers would suggest needs improvement)?

Average DC plans often have insufficient participation, low savings rates, poor participant diversification, murky fee disclosure, and too many investment options that are not of institutional quality. When stated this way, average might not sound like such a good benchmark. In every aspect of our lives, we strive for excellence. We believe DC plans should strive for excellence, as well.

The good news is we have a pretty clear idea of what we believe needs to be done to achieve plan excellence. Here are key attributes that all excellent DC plans share and the actions you can take to help make sure your plan is positioned for excellence.

How does Russell define an “Excellent” Plan?

It’s easy to point to a survey to define an average result. But how does one define an *excellent* result? At Russell, we believe this is achieving a result that will help participants meet their retirement needs. What determines excellence can differ for each plan. In this paper we have identified, based on our experience, what we believe most plans will need to strive for in order to better the chance that their participants will achieve a secure retirement.

Attribute #1 – A Retirement Income Mindset

First, change the attitude of participants.

Average Plan – Each quarter, plans report current account balances to their DC participants; in fact, Department of Labor guidelines require it. Plan sponsors monitor how much participants have saved. The average balance is around \$71,000.¹ While most plan sponsors know this isn’t enough, their participants may have no way of knowing where they stand in terms of their retirement readiness. Imagine packing for a vacation without knowing your destination. How would you be able to plan for what you need? Retirement participants who focus only on their balances are faced with that issue.

Excellent Plan – Excellent plans provide gap analysis disclosure or a statement with retirement income projections to participants as a standard part of their reporting. This helps participants better understand their retirement readiness and set the right savings rate.

¹ “How Well are Employees Saving and Investing in 401(k) Plans: 2010 Hewitt Universe Benchmarks.”

Action Items – Develop a Target Replacement Income (TRI) goal for the plan and design default and company match rates with this TRI in mind.² Work with your recordkeeper to enhance your plan’s statements to take the focus away from wealth accumulation and place it on retirement income. Excellent plans of the future may include post-retirement products, such as annuities and other payout approaches.

Attribute #2 - A Thoughtfully Designed Plan Menu

Streamline “Tier II” and make it simple.

Average Plan – The median plan still offers 22 options (13 if you only count Tier II, or single-asset-class offerings), with 26% of plans offering a brokerage window for expanded choice.³ Great strides have been made to reduce the number of menu options but there is still a legacy from the 1990s, when the prevailing trend was to demand more choice. The average plan is trimming investment options at the margins, but not making wholesale menu design changes.

Excellent Plan – An excellent plan identifies the participant profiles they are trying to serve in each tier of the investment menu. There are three typical profiles: Do It For Me, Do It With Me and I’ll Do It Myself.⁴ We recommend plans utilize a three-tiered structure designed to satisfy each profile. This “choice architecture” allows a participant to easily identify with a profile and pick from the respective tier. For the second tier (Do it with me), offering a limited set of options (5 to 8) aids participants’ allocation and decision-making. To achieve this, excellent plans are collapsing options into major categories or providing premixed risk-based allocations. For example, instead of growth, core and value large cap equity fund options, they are combining these choices into a single, diversified large cap option, allowing “Do it with me” participants to tailor their allocations to their needs and beliefs.

Action Items – Identify participant profiles and design a menu to satisfy different profiles’ needs. Consider offering a limited number of broad multi-manager and multi-style funds as core options. To provide more choice for the minority who demand it, consider offering a brokerage window.

Attribute #3 – Best-of-Breed Investments

Move outside the recordkeeper’s “box.”

Average Plan – In 2008, 55% of all DC investment assets were affiliated with the recordkeeper.⁵ This is a vestige of the early days of DC, where generous revenue sharing arrangements or proprietary requirements were put in place to give plans an incentive to pick their recordkeepers’ funds. Plan sponsors need to realize that they are able to move away from this structure and use only who they believe are the best managers.

Excellent Plan – We believe an excellent plan makes decisions on the funds to offer, including target date funds, based on investment merits and analysis. An excellent plan understands that no one provider can be best in all asset classes. Providing the best available investment options and structures to participants is more likely to lead to better outcomes.

Action Items – Use the upcoming DOL fee disclosure regulations to separate investment fees from administrative fees and evaluate the fairness of how participants pay for administration. Move to provide the best available investment options and formats to participants.

² For more information, see Cohen, Josh and Dan Gardner, “What’s the right savings rate?”, *Russell Research Commentary*, August 2011.

³ *2011 Trends and Experience in Defined Contribution plans*, Executive Summary. Hewitt Associates (2011).

⁴ For a discussion, see Jones, Ben, “Redefining the menu: Embracing behavior-driven defined contribution investment menus,” *Russell Research Commentary*, September 2010.

⁵ [Target-Date Retirement Funds: The New Defined Contribution Battleground](#). Casey Quirk and PSCA. (November 2009).

Attribute #4 – Appropriate Participant Diversification

Be a guide to your participants.

Average Plan – The typical plan has just 8.2% of plan assets in a target date fund and only a handful of participants making use of managed accounts.⁷ Up to 18% of plan assets are in company stock and 13% in stable value options.⁶ Also, many participants don't appear to have an appropriate allocation relative to their years until retirement.

Excellent Plan – An excellent plan has 60%+ of participants in an asset allocation strategy (target date, balanced or managed account). This is the minimum allotment we see in plans whose participants are defaulted into such strategies, either upon enrollment or re-enrollment. Many plan sponsors have embraced asset allocation default solutions, such as target date funds, for new employees. Excellent plans have also realized that legacy participants' investment allocations may not be the most appropriate.

Action Items – Consider a re-enrollment campaign to follow your menu re-design. This provides current participants with an opportunity to find the right investments to fit their profile, stay with their original allocation or be defaulted into the plan's Qualified Default Investment Alternative (QDIA). Give both short- and long-tenured participants the same opportunity to benefit from appropriate asset allocation.

Attribute #5 – Effective Employee Education

Focus on financial education.

Average plan – Though often used interchangeably, financial education and investment education are different concepts. An average plan may address both, but will be more focused on investments and asset allocation concepts, rather than retirement planning and saving concepts. In fact, some retirement education can actually cause participants to disengage from the process. Imagine taking your watch in to be repaired and being given instructions on how to repair it. The vast majority of participants are not looking to become investment experts; they are looking for tools to provide them with answers.

Excellent plan – Excellent plans understand that many participants lack basic financial literacy. Instead of teaching participants to be investment experts, they focus on how to help participants develop an overall financial plan for retirement and how to successfully use the tools available to them to implement one. Primarily, participants need to know how much they need to save for retirement, what that will equate to in terms of income at retirement and if they are on track to reach their objectives.

Action Item – Provide your participants with financial education that focuses on helping them determine their investment type and guides them to the correct tier on the plan's investment menu. Be sure to incorporate tools that put the focus on a retirement income mindset. Design your education and communications on how to establish a retirement income goal and work backwards to what participants need to save to meet their desired goals. Then, provide them with regular updates on progress, like a gap analysis, so they can adapt to changing circumstances as needed to stay on track.

Attribute #6 – High Contribution Rates

Give participants the best chance of success.

Average Plan – The single biggest factor in participants' success is their savings rate. Most plans receive a yearly report on participant savings rates from their recordkeeper, and the average deferral rate is about 6.8%.⁷ Knowing that the savings rate is "about average" won't help your participants achieve their goals, especially when the

⁶ PSCA's 54th Annual Survey of Profit Sharing and 401(k) plans. Hewitt's Trends and Experience in 401(k) plans cites similar figures for assets in target date (11% when offered), company stock (21% when offered), and stable value (30% when offered). On balance, Hewitt tends to survey larger plans, but PSCA surveys plans of all different sizes.

⁷ "How America Saves." Vanguard (2011)

average savings rate is too low.

Excellent Plan – Per Attribute #1, plans that focus on the retirement income mindset can define participant success in terms of a specific Target Replacement Income (TRI) goal. Russell's research shows that to achieve a high degree of certainty around a TRI goal, your participants will likely need to save **10 percent or more** of their salary, in addition to an employer matching contribution. Excellent plans use many tools to help achieve this goal including: save more tomorrow (auto-escalate), the company contribution formula to incentivize higher savings, targeted campaigns, and education that is focused on savings behavior.

Action: Determine a targeted savings rate. Structure the company contribution formula and plan communications around these ideas. Consider utilizing tools like higher default rates and auto-escalation to ease participants into the retirement income mindset and successful savings behavior.

Attribute #7– High Participation Rates

Get everybody involved.

Average plan – Participation rates around 70% to 74% have been prevalent for the past six years⁸. Odds are your plan is similar. An average plan will help to move the needle over time, but fall short of increasing participation by more than a percent or two each year.

Excellent plan – Strive for participation rates above 90%. Making the jump from average to exceptional takes fortitude and proactive persistence. For excellent plans, auto-enrollment is one way of overcoming participant inertia, but more importantly stay tenaciously focused on increasing, attaining, and sustaining high participation rates. Excellent plans know that the right financial education combined with a well designed plan can make all the difference.

Action Plan – Decide if auto-enrollment is right for your plan. If you already use auto-enrollment, consider doing a complete re-enrollment during your next open enrollment cycle. Finally, if you have recently done both, use targeted easy enroll (one click/check) campaigns.

Conclusion:

In every aspect of our lives, we strive for excellence. In this article, we have described seven attributes of excellent plans. You will notice from this article that excellent plans do not happen by accident; it takes a process starting with the end in mind, fortitude and persistence to achieve excellence. We have laid out several steps you can take this year to help move your plan from average to excellent.

For more information, call your Russell representative at 1-800-787-7354.

⁸ Sources: PSCA's 54th Annual Survey of Profit Sharing and 401(k) plans, 2011; How America Saves." Vanguard (2011); Hewitt 2009 universe benchmarks,

Attribute	Average Plan	Excellent Plan	Corrective Action
Retirement Income Mindset	Focuses on account balances	Has embraced a Retirement Income Mindset	Set Target Replacement Income (TRI); design your plan communications around it and measure success. Approach your recordkeeper and other service providers to assist you in incorporating the right tools into your plan.
A thoughtfully designed menu	Trims options at the margins	Thinks about the delivery of options to meet participant investment types	Consider a move to a three tiered structure. Offer target date funds for the tier I majority. In tier II, collapse options like growth and value into one offering and offer broad multi-manager and multi-style funds.
Best in class investment offerings	Offers proprietary and single manager solutions	Embraces open architecture, best-of-breed investment options	Explore the open architecture options available to your plan. Separate investment and admin fees; Engage in a detailed evaluation of your investment options
Participant Diversification	Small percentage of the plan invests in target date funds	Strives to find ways to increase the percentage of participants in an asset allocation strategy	Conduct a re-enrollment campaign as you update your plan menu. Help participants diversify by defaulting those that don't take action to the appropriate target date fund.
Employee Education	Focuses on investment education	Focuses on financial education and retirement income goals.	Utilize your tiered menu to help participants develop a plan. Work with your recordkeeper to provide participants with information on their retirement income so they can work backward and determine the right savings rate.
Savings Rates	Settles for a 6-7% employee savings rate	Utilizes auto features to drive savings rates greater than 10%	Use the TRI you determine for your plan to design your auto features and drive your communications plan.
Participation	Has fallen into a participation rut of 70-74%	Strives for 90%+ participation	Review your plan features to ensure you are utilizing your auto features to their full extent. Consider re-enrollment.

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A target date fund may be a fund of funds which exposes an investor to the underlying fund specific risks in direct proportion to the underlying funds' allocation. Investors may pay costs for the fund and for the underlying funds in which the fund invests. Total fund costs may be higher than those incurred when buying an individual fund.

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