Getting Beyond Ordinary
ADVANCES IN AUTOMATIC SAVINGS PROGRAM DESIGN

INTRODUCTION

Defined contribution plans have experienced significant growth in the adoption of automatic savings programs since the 2006 introduction of the Pension Protection Act (PPA). While these programs have generally delivered laudable results, their progress can be hindered by certain plan designs:

1. Plan designs incorporating relatively low default rates often result in lower savings rates.
2. Since its inception, automatic enrollment has been applied primarily to newly eligible employees, largely ignoring a substantial number of nonparticipating existing employees.
3. A growing number of plan sponsors have implemented automatic increase programs, but these programs have often been applied on an opt-in basis rather than an opt-out basis, thereby limiting their impact.

At T. Rowe Price we view these early automatic programs as an important first step to overcoming employee inertia. The next step is to evolve these programs and combine them in ways that produce greater results per dollar of employer cost.

This paper explores the merits of solutions that involve the following:

- Auto-enrollment for employees at higher initial default rates,
- Auto-enrollment for employees who are not currently enrolled,
- Auto-increases in deferral rates on an opt-out basis, and
- Auto-investing in a qualified default investment alternative (QDIA).

AUTOMATIC SAVINGS PROGRAMS VERSION 1.0

Results from basic programs suggest high potential for improvements

Employers facing participation challenges that often complicated plan administration and curtailed savings for highly compensated employees found auto-enrollment to be an attractive solution. Armed with specific guidance and limited protections offered under the provisions of the PPA covering QDIAs, employer fears about market fluctuations or the effects of investing too conservatively fell to the wayside, as did the previous ambiguity regarding the application of state-level restrictions concerning automatic withholding of payroll.

Today, 62% of plan sponsors participating in a recent survey, report offering automatic enrollment programs, with 85% of those sponsors using target date or life-cycle funds as the default investment vehicle. However, the overwhelming majority of plan sponsors surveyed (62%) only auto-enroll new hires (Deloitte, 2015). And while participation rates continue to rise in these programs, the majority of plans (55%) are utilizing a default rate of 3% (Deloitte, 2015).

This default rate mirrors both safe-harbor guidelines and early government illustrations of the impact of automatic enrollment programs, which frequently used 3% savings in modeling. The 3% rate also reflects a generally held belief that this deferral rate is likely to decrease the instance of participants opting out, even though there is no definitive evidence that higher default rates would result in higher opt-outs.

In addition to applying automatic enrollment utilizing the QDIA, many plans are also using automatic increase programs to drive escalation of deferral rates. Sixty-eight percent of T. Rowe Price Retirement Plan Services, Inc. (RPS), clients have adopted some form of automatic increase program. However, 62% of those plans utilizing this feature do so on an opt-in basis. This opt-in approach resulted in only 11% of participants opting in to the program. Of those plans offering the program on an opt-out basis, 68% of participants remained in the program, further supporting the evidence that automation effectively overcomes participant inertia (T. Rowe Price, 2014).

Of those plans offering the [auto-increase] program on an opt-out basis, 68% of participants remained in the program

Early adopters of automatic savings programs were pioneers who were often seeking ways to help their retirement plans operate more effectively and for employees to become more self-reliant and better prepared for retirement. According to AARP's June 2010 survey of plan sponsors:

- 74% of respondents reported that the reason for implementing auto-enrollment was to help employees save more,
- 49% did so to make it easier to pass nondiscrimination testing, and
- 35% were motivated to demonstrate that they were a socially responsible company.

The motivation and progress in getting a greater number of participants to save more is extremely encouraging. At the same time, these basic approaches to automatic savings programs raise some serious questions:

- Will participants who fail to engage in active retirement planning and move beyond the initial default rate established by their plan sponsor interpret the default as the "proper" savings rate for their retirement?
- Will opt-in approaches to deferral increases move the needle enough to fuel adequate savings as more people are enrolled at low initial automatic default rates?
- Will the employees who joined the firm prior to auto-enrollment and QDIA availability be left on their own while new employees are automatically enrolled?
- Does the firm's current adoption of the basic automatic programs align with and accomplish corporate goals and provide an adequate level of retirement income for employees?

These important questions, along with recent research indicating that there is an overwhelming plan sponsor interest in helping improve participant retirement readiness, set the stage for the next evolution of automatic savings programs where

KEY FACTS CITED IN THIS PAPER

- When asked to rank the most important topics to the organization, "providing the right investments to help participants achieve retirement goals" and "retirement readiness of active participants" rated numbers one and two, respectively (Deloitte, 2015).
- The overwhelming majority of plan sponsors (62%) auto-enroll new hires only (Deloitte, 2015).
- The majority of plans (55%) are using a default rate of 3% or less. This is one reason why today's average deferral rate remains stagnant and well below what experts generally recommend (15%) (Deloitte, 2015).
- When automatic increase was offered on an opt-in basis, only 11% of participants chose to opt in versus 68% who chose to stay in when it was offered on an opt-out basis (T. Rowe Price, 2014).
- According to a recent survey, the percentage of employers enrolling nonparticipants into their plan doubled from 8% in 2013 to 16% in 2015 (Aon Hewitt, 2015).

more comprehensive application of auto-enrollment, auto-increase, and auto-investment strategies are combined to drive better outcomes.

SIXTY-TWO PERCENT OF PLAN SPONSORS RESPONDED AFFIRMATIVELY TO THE SURVEY SELECTION:

"We feel that our responsibility includes taking an interest in whether our employees are tracking towards a comfortable retirement." (Deloitte, 2015)

EVOLVING AUTOMATIC SAVINGS PROGRAMS

Linking to retirement readiness is essential for continued success

The next generation of best practice considerations in retirement plan design aims at improving retirement readiness and reflects a renewed corporate sense of responsibility for successful retirement outcomes.

> The full power of automatic programs rests in the deployment and integration of multiplefeatures

We characterize automatic savings programs in three categories—basic (as discussed previously), enhanced, and advanced. These programs start with core elements of automation and build upon those basics with features that expand employee coverage and maximize savings and investment impact. The full power of automatic programs rests in the deployment and integration of multiple features that, when combined, achieve plan and participant objectives within the constraints of corporate benefit budgets.

This spectrum of programs provides sponsors with additional options to redesign their plans with a customized combination of features to:

- Better achieve their plan's objectives, and
- Consistently improve retirement readiness for a broad range of employees.

The selection of these features should be guided by an analysis of employee demographics and a fresh evaluation of how the benefit program supports the company, the plan, and the employee's goals.

COMBINE THE FEATURES THAT BEST ALIGN WITH CORPORATE AND BENEFIT PROGRAM GOALS*

Key Elements in Successful Outcomes	Basic Program	Enhanced Program— Basic Program, Plus:	Advanced Program— Enhanced Program, Plus:
Participation	▪ Auto-enroll new employees at low default savings levels	▪ Auto-enroll all eligible employees at higher initial default rates	▪ Periodically reenroll nonparticipating employees
Savings Adequacy	▪ Improve savings adequacy with opt-in auto-increase	▪ Implement annual auto-increases in deferral rates on an opt-out basis ▪ Implement "auto-boost" deferral rate increases to bring savings rates up to the minimum default rate or up to the maximum matching contribution level (if offered)	▪ Periodically reenroll participants who have previously opted out of auto-increase
Diversification	▪ Provide diversified investments that align with each participant's retirement time horizon ▪ Auto-default into QDIA	▪ Reset improperly diversified portfolios to QDIA	▪ Selectively reset (periodically) improperly diversified portfolios to QDIA

Utilize an opt-out approach to fully harness inertia to help achieve retirement readiness.

* Possible automatic program features highlighted in this section are ultimately the decision of the plan administrator, and each option may need to be reviewed in consultation with the company's retirement plan committee, advisor, and/or legal counsel.

ENHANCED PROGRAMS

These steps build on the success of the basic automatic programs

Enhanced Features to Improve Participation

Enhanced programs can have a greater impact by applying automatic enrollment features to all eligible employees—not just the newly eligible. More recent adopters of auto programs seem to be attracted to this approach. According to a recent survey, the percentage of employers enrolling nonparticipants into their plan doubled from 8% in 2013 to 16% in 2015 (Aon Hewitt, 2015).

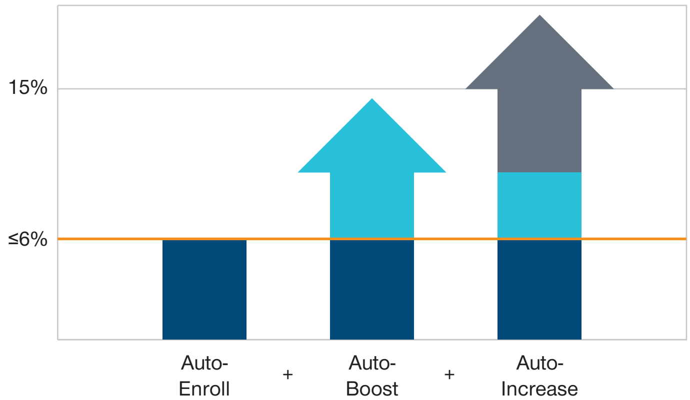
Enhanced Features to Improve Savings Adequacy

Some experts estimate that savings rates as high as 15% throughout the working years are required to accumulate sufficient funds to sustain one's lifestyle in retirement. With today's average salary deferral stagnant, plans need to have effective programs for increasing participant deferral rates.

Auto-increase features offered under an opt-out arrangement are designed to address this situation.

Auto-boost is another particularly effective technique for existing participants, which jump-starts the auto-increase feature by automatically boosting deferral rates for existing participants. Different versions of auto-boost can be used to elevate participant deferral rates to do the following:

- Bring participant savings levels up to the minimum default level where applicable or
- Maximize the company match if one exists.



Kick off an automatic increase program by implementing a one-time automatic "boost."

For example, if a plan adopts automatic enrollment for new hires at a default rate of 6%, and if it implements an employer match of 100% on the first 6% of employee contributions, new hires automatically are maximizing the match at the point of enrollment. However, there may be existing participants who are still saving below that rate. Auto-boosting these participants to 6% immediately maximizes their receipt of the employer match. Thereafter, an annual automatic increase program for all participants offered on an opt-out basis continues to raise the employee savings rate until it reaches a combined 15% employee and employer contribution rate.

Combining automatic boost with automatic annual saving rate increases can help participants achieve the savings rates necessary for accumulating meaningful retirement balances.

Enhanced Practices for Addressing Diversification*

Creating good saving behavior utilizing automatic participation, auto-increase, and auto-boost features can provide more adequate cash inflows. Pairing good saving behavior with a well-diversified investment plan can help grow those cash inflows into the higher account balances needed to adequately fund retirement income needs.

A well-chosen QDIA solution is often the easiest way for participants to keep their investment portfolio on track, and many plan sponsors have taken advantage of the fiduciary protections associated with QDIAs. However, nearly 45% of sponsors are not familiar with the possibility of utilizing QDIAs through automatic reset programs as a way of correcting improperly diversified participant investments (Deloitte, 2012).

Enhanced programs automatically reset participant investments on a one-time basis into a QDIA with an appropriately communicated opt-out offer. This automatic investment reset approach can be applied in multiple ways, as outlined below.

Targeted Populations for Automatic Reset	Examples
Selectively to participants invested in a default option prior to the introduction of a QDIA	▪ If the plan had a stable value fund as the default option prior to the introduction of the QDIA, automatically reset those participants who were defaulted into the stable value investment or who hold 100% in a stable value fund.
Selectively to participants who have improperly diversified portfolios	▪ Participants who have high concentrations in one nondiversified position. ▪ Participants who have evenly spread their money to each target date investment within the series.

The primary objective of these practices is to help ensure that participants who appear to need guidance are given opportunities to affirm their decisions or automatically take advantage of a more diversified investment alternative.

*Possible automatic program features highlighted in this section are ultimately the decision of the plan administrator, and each option may need to be reviewed in consultation with the company's retirement plan committee, advisor, and/or legal counsel.

These reset programs may provide unengaged participants with a better chance of reaching their retirement goals. It is possible that some participants who actively elected an undiversified portfolio may be inadvertently scheduled for the reset. Therefore, a strong communication program including an easily executed opt-out offer is critical for both sponsors and participants.

ADVANCED PROGRAMS

Keeping employees engaged with higher savings rates and diversified investing is the mark of a successful plan

Advanced programs take automation beyond the one-time impact activities of the enhanced features. They implement automatic features on a periodic basis to solve for concerns over participant savings rates or lopsided asset allocation. The advanced programs are an effort to get nonparticipating employees enrolled and existing participants appropriately diversified and saving at a robust level. This may be the most important action plan sponsors take to help employees achieve retirement readiness.

Advanced Features for Participation and Savings Adequacy

Participants can respond to automatic savings programs differently at different points in time with different personal situations. Periodic reenrollment of nonparticipating eligible employees can offer these employees a chance to rethink their decision at regular intervals during their working life. Periodic reenrollment offered via an opt-out approach can help overcome inertia in voluntarily revisiting previous actions.

Similarly, participants who have previously opted out of an annual automatic increase feature may be able to save more as their situations change. A periodic reenrollment of participants not taking advantage of an annual automatic increase feature can assist them in revisiting their decision and may cause them to both accept the automated annual program and raise their current rates due to a change in the circumstances that caused the original opt-out. Research shows that for every five years retirement savings is delayed after age 25, an additional contribution of 4%–5% of pay per year is needed (Aon Hewitt, 2015).

More Active Investment Monitoring

Advanced plan sponsor programs also monitor for potentially nondiversified investment patterns—and build on the one-time activities of enhanced programs—by resetting nondiversified participant portfolios and elections into the plan's QDIAs on a predetermined frequency.*

Providing appropriate investments to help participants achieve retirement goals was rated by 89% of plan sponsors to be "quite important" or "very important" (Deloitte, 2015). This attitude has resulted in strong plan investment choices and strong investment monitoring of the menu options. Too often, however, plan participants are left on their own in using the plan's investment menu, in spite of observable patterns of limited diversification. And according to an Aon Hewitt research report, a 1% difference in future return on assets can result in a two-times-pay difference in retirement resources (Aon Hewitt, 2012).

Measuring and Improving Retirement Preparedness

There is a growing and discernible corporate concern for facilitating individual retirement readiness. According to the 2015 401(k) Benchmarking Study, 62% of plan sponsors responded affirmatively to the survey selection: "We feel that our responsibility includes taking an interest in whether our employees are tracking towards a comfortable retirement." (Deloitte, 2015)

Objectively measuring the effectiveness of the company's plan and reacting appropriately is essential to the success of the participant and the retirement program. When matched with a clear view of corporate goals and benefit program objectives, a retirement preparedness analysis can help determine:

- Initial default savings rates
- Targeted savings escalation rates
- The consequence and impact of AutoBoost® features
- The impact of investment default resets
- Which employee populations to target—including the impact of excluding existing employees
- The overall impact—in terms of costs and projected retirement readiness—of benefit program practices.

ANALYSIS TOOL HELPS GUIDE DECISIONS

T. Rowe Price offers the Plan Meter® service to assist plan sponsors in choosing the optimal combination of features and helping them understand the impact automatic program features may have on retirement adequacy.

Plan Meter® is a retirement preparedness analysis tool designed to quantify the ability of plan participants to replace their current income in retirement compares existing plan design and participant behaviors with projected outcomes from adopting discrete automatic program features.

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Recognizing that each company has different needs and employee demographics, a combination of automatic features can be structured to create a customized solution for each plan.

This “advanced” approach to the design and deployment of automatic programs provides sponsors with an expansive range of options that can be aligned with corporate goals to achieve desired retirement outcomes within a targeted program budget.

IMPORTANT CONSIDERATIONS FOR AUTOMATIC SAVINGS PROGRAMS

Successful improvements begin with a careful review of plan sponsor concerns, employee response, and cost considerations

Though automatic savings programs can be highly effective in producing better retirement outcomes, some plan sponsors may have lingering concerns that preclude them from aggressively adopting such programs, citing fiduciary concerns, employee response, and cost as primary factors for not yet implementing the programs.

Plan Sponsor Considerations

Plan sponsor concerns over their role as fiduciary span from determining whether automatic programs are appropriate for their specific circumstances to tackling the inertia associated with maintaining the status quo.

While the protections of the PPA provide specific relief for automatic savings programs, implementing enhanced and advanced savings and investment programs may seem to be too progressive to certain risk-adverse plan sponsors.

So what is a successful plan? Traditional measures include evaluation of factors such as participation rates, savings levels, and the performance of investment options relative to selected benchmarks. These metrics do not, however, accurately capture a plan’s potential to provide its participants with retirement income adequacy: helping plan participants build sufficient savings to achieve their goals while working so that they can support their income needs in retirement.

Multiple research studies make it clear that most people want and need help with their retirement savings and investing—and that far too many are woefully unprepared. For sponsors advanced automatic programs may be an expression of their commitment to support more successful savings and investment outcomes. Improved outcomes for plan participants, expressed as retirement readiness projections and other more advanced metrics, may provide assurances to plan sponsors regarding more progressive automated strategies.

With the 10th anniversary of the PPA approaching, a best practices framework has evolved that recognizes the ideas and importance of this significant legislation. This paper addresses many factors in this framework and can help plan sponsors:

- Evaluate existing plans
- Develop thoughtfully designed plans
- Maximize the effectiveness of automatic feature programs
- Identify and address suboptimal plan participant behavior

Automatic savings programs have proven to move the needle in the right direction. As always, plan sponsors should carefully consider the approach and actions that will prove most valuable and appropriate for their participants.

Multiple research studies make it clear that most people want and need help with their retirement savings and investing

Employee Response Considerations

Some reservations about automatic programs revolve around perceptions that employees would object to automatic actions. In fact, 32% of plan sponsors who did not implement automatic programs said they did not do so because they did not want to be perceived as forcing participant deferrals (Deloitte, 2015). Our clients have, in fact, demonstrated that participants embrace automatic program features:

- Of those automatically enrolled, only 10% have opted out.
- Of those enrolled in an annual automatic increase program, 68% remained in the program.
- Of those investing their entire balances in a target date investment, most likely the default option, the percentage has nearly doubled to 46% over the past seven years (T. Rowe Price, 2014).

Communications play a vital role in transitioning to or evolving automatic savings programs. The perception of someone doing something ‘to you’, as opposed to ‘for you’, may always be present. However, the way in which the program is communicated and the ease with which one is given the option to say “no thank you” are key determinants in positively addressing potential objections.

Ultimately, the resistance of the few who do opt out must be weighed against the benefits to the majority who begin saving, increase their savings, invest appropriately, and stay enrolled in the plan.

Cost Considerations

Managing the employer’s cost of providing the plan is an important dimension to plan design. For most current designs, the more effective the programs are at getting better participation and higher savings rates, the higher the employer's cost. Fortunately, there are multiple design approaches that can be used to provide comprehensive automatic features and still contain and manage the employer's cost within acceptable levels.

For any given level of retirement program success, key determinants of the employer's cost are:

- The magnitude and structure of the employer contributions
- Eligibility schedules
- Vesting schedules

With judicious design and configuration of these parameters, it is not difficult to construct highly effective programs that are tailored to contain employer costs within desired budget levels. However, it is important that such a plan redesign be guided by a thoughtful evaluation of the company's strategic objectives related to the demographics, skills, and growth of its employee base, and the impact of plan design changes on employee relations and morale. In addition, a carefully designed employee communications program, whether implemented all at once or phased in over time, should precede the deployment of such programs.

A DEEPER LOOK INTO COST EFFICIENCIES

The T. Rowe Price white paper, Getting Beyond Ordinary—Managing Plan Costs in Automatic Programs, explores in depth various means of controlling plan costs through creative plan design while fully utilizing the best practices of automatic programs.

Social Considerations

According to a recent Aon Hewitt study, roughly two out of five workers who participate in their employer's benefit plans for their entire career are expected to be on track to retire with reasonably adequate retirement income. That leaves three out of every five full-career contributing employees (59%) who are not expected to have saved enough to retire at age 65 (Aon Hewitt, 2015).

When you include other workers, mid-career hires, and nonparticipants, only one out of every five employees (22%) is expected to be able to meet their retirement income needs by age 65.

The majority of these underprepared retirees are likely to be the groups that have historically under-saved: minorities, women, and low- to mid-level income earners. This same group may be the most harmed by changes in Social Security, an earnings-based program, if such changes shrink their ability to replace retirement income. Retiring at 65 today takes the form of a lower monthly benefit.

Automatic savings features in defined contribution plans can significantly improve these results. In the Aon Hewitt study, companies with automatic enrollment have savings plan participation rates of 84%—more than 20% higher than those companies without automatic enrollment.

Employees who are automatically escalating their contributions are much more likely to be on track. Over 70% of full-career contributors who are escalating are projected to have near-adequate resources at age 65. However, only 22% of full-career contributors with access only to defined contribution plans are escalating their contributions. The better news is that this percentage is on the rise.

When considering improved participation, higher savings rates, and diversified QDIA investments experienced in fully automatic-featured plans (as evidenced in the Aon Hewitt and other studies), there is growing evidence that automatic programs will play an important role in improving the future retirement outcomes of Americans.

Workplace Considerations

An additional consequence that may result from mass retirement inadequacy is the likelihood that more aging Americans will stay in the workplace longer—if not for the salary, then for the health care benefits. Some retirement-age boomers have already opted to work longer to keep mentally and physically active, as well as to support their costs of living.

Yet according to Employee Benefit Research Institute, each year, a sizable proportion of workers retire sooner than they had planned. Those who retire early often do so for reasons such as health problems or disability or the loss of their job.

Moreover, while 70% of workers say they plan to work after they retire, only 27% of retirees report having done so. Aside from health and caregiving issues, finding full- or part-time work during retirement may be more difficult than expected.

If working into our 70s is to become the norm, there will likely be an impact on overall worker productivity, new talent acquisition opportunities, health care costs, and even morale due to the multigenerational differences and biases that may be more prevalent in the workplace.

CONCLUSION AND NEXT STEPS

Today's plan sponsor is faced with expanding challenges in offering effective employee benefit retirement plans in an environment of constrained budgets. Through advanced use of comprehensive automatic programs and thoughtful plan design, employers can achieve substantial improvement in plan success measures within the company cost constraints.

Whether a firm is considering an automatic program for the first time or if basic automatic features have already been implemented, here are some practical steps that can be taken today to improve the effectiveness of the plan and align corporate decision-making with the overall objectives and philosophy of the benefits program:

Step 1: Conduct a plan analysis

Step 2: Set long-term plan objectives and near-term goals

Step 3: Choose and implement the right combination of automatic program features that best align with the firm's goals

Step 4: Model, analyze, and refine the features to maximize retirement readiness within employer cost constraints

T. Rowe Price can assist you with the following:

- Thorough understanding of your employee demographics,
- Range of program features to align with your goals, and
- Detailed modeling of both costs and retirement preparedness projections based on various proposed changes.

Contact your T. Rowe Price representative to discuss these approaches and get started on the solution that's right for you.

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