Retirement Plan Consulting & Investment Advisory Services

From Good to Great

Seven Ways Your Retirement Plan Can Make the Leap

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Introduction

You may have opted to include a retirement program in your benefits package to protect and provide for your employees, attract and retain top talent, or perhaps a different reason. Whatever your philosophy was in implementing your program, one thing is clear: the market volatility of the past few years and poor employee savings rates has resulted in diminished confidence in the defined contribution arena. And unfortunately, DC plans are the primary vehicles in which future retirees must rely in order to get them to retirement. Without a great plan design and strategy in place, individuals will be left inadequately prepared to leave the workforce. Consider the impact on the enterprise that fails to implement a successful retirement plan[1]:

- **Increased volatility in staffing needs**: Decisions to delay retirement are impacted by economic conditions; good market performance increases the probability of an individual choosing to retire, while poor market performance may dissuade someone from retiring.
- **Increased workforce costs**: Annual healthcare costs for a 65 year old employee are twice that of an employee age 45-54. Employee productivity with respect to age is more complex to measure, but should also be taken into consideration.
- **Reduced workforce engagement**: Delayed retirements reduce the opportunity for younger staff members to advance in their careers, resulting in lower morale and potentially higher turnover.

In order to achieve 401(k), 403(b), profit sharing, or other retirement plan "greatness", it's time to draw on what we know and understand from other industries in order to make the leap. Ask any successful corporate leader what is in his or her personal library, and you may hear the title From Good to Great. This 2001 influential management book by Jim Collins details the seven common features of companies that transcended beyond their average financial performance to become industry leaders and dominate their competition – companies like Walgreens, Kroger, Philip Morris, and Pitney Bowes.

By applying the same seven traits outlined by Jim Collins as identified throughout this whitepaper, you can get your retirement savings plan back on track, and smash through the goals and objectives you initially identified when creating the program.

Trait 1: Level 5 Leadership

Collins described the leaders of great companies demonstrating a blend of personal will and professional humility – that is, they are humble but driven to do what's best for the company. For your retirement program, level 5 leadership can be attained by understanding that no one person is going to have all of the right answers to do what's best for your employees. Great retirement plans are built by individuals who are willing to go beyond their fiduciary responsibilities in making decisions about retirement plan design and participant education.

[1] Prudential Financial. "What Employers Lose in the Shift from Defined Benefit to Defined Contribution Plans… and How to Get it Back." July 2011, p. 5

Therefore, it is important to shoulder tap individuals who, although they may bring different areas of expertise to the table, share one common goal: decisions made will always benefit employees first and foremost. While you may have referred to these individuals as your 401(k) committee or something of a similar nature, they're really the starting lineup of your retirement team, as they're working together for the common good of your most valued asset, the people that make up your enterprise.

According to a recent Forbes article, a common characteristic of a great 401(k) plan is that the plan hired an investment fiduciary.[2] The Department of Labor (DOL) requires that companies hire an expert if they do not have the expertise; the best plan sponsors know that the plan and the participants are best protected by the fiduciary standard rather than the suitability standard of broker dealers and insurance companies, as the investment fiduciary must keep the plan and the participants' interests foremost at all times.

Other individuals that should be represented on your starting lineup should come from the following areas:

- C-Suite
- Human Resources
- Finance
- Employees

Trait 2: First Who, then What

The companies that made the transition to greatness all identified individuals that shared the core values of the organization first; then, as a team, those individuals decided where to take the organization as a whole.

With your "Level 5 Leadership" starting lineup in place, including your co-fiduciary advisor, you can begin engaging in discussions to create and implement your ideal retirement strategy. There are five major considerations that should be part of your "What" decision-making:

Corporate Retirement Philosophy: Having a philosophy means determining what your main goal is for your retirement plan. This concept is detailed further in the next section, "The Hedgehog Concept."

Fiduciary Governance: Having a clear, repeatable, prudent process in place and educating plan committee members about their fiduciary obligations is key to mitigating fiduciary risk. Establishing a retirement committee charter, creating an investment policy statement, and scheduling regular meetings to review the reasonability of fees and monitor investment performance is critical to demonstrating that a diligent, intentional standard of care was applied in creating a beneficial retirement program. Identify and work with a co-fiduciary advisor who has demonstrated experience in establishing these processes.

[2] "5 Characteristics of a Great 401(k) Plan," by Michael Chamberlain, Forbes.com, 5/31/2011

Investments: Great retirement plans include the right mix of investments, giving participants the chance to diversify as appropriate to their risk tolerance and duration to retirement. Given that 90% of the population prefers to have someone else create their asset mix[3], your plan's qualified default investment alternative (QDIA) should include an asset allocation strategy or target date fund. For the remaining 10% that prefers to pick their own investments, include a mix of active and passive strategies that span approximately seven different asset classes. Your advisor can help you monitor and select the fund line-up that is appropriate for your population.

Plan Design: A great plan design gets individuals saving in the plan at the right savings rate in the right investment mix. Studies suggest that you can be reasonably assured that your participants are on track towards retirement if your plan has a 90% participation rate with a 10% average deferral rate, and 90% of the population is in an asset allocation strategy or a target date fund.[4] However, due to employee inertia, these targets may be difficult to achieve without implementing automatic savings features such as automatic enrollment and contribution escalation. More information on automatic features and the concept of the plan design "flywheel" is detailed further below.

Education: Implementing automatic features does not eliminate the need for a strategic communication and education plan. Employees are increasingly looking to their employers for guidance on retirement savings and general financial wellness[5]. A well thought-out education strategy will help employees:

- Understand the value of their retirement savings benefit;
- Avoid actions that impact their retirement security such as taking loans, hardship withdrawals, or early cash outs upon termination of employment; and,
- Project monthly income in retirement to easily determine whether or not they are on track to retire successfully; and
- Take immediate action with regards to savings and investment choices.

Your service provider can often help with general communication and education efforts that span various media such as print, electronic, and direct mail. For better results and greater plan success, work with your advisor to implement a more personalized strategy that can target individuals based on participation status, age, income level, and other characteristics.

[3] "Plan Success: Practical Behavioral Finance Solutions to Improve 401(k) Plans," by Shlomo Benartzi, PhD. Lecture given in partnership with Allianz Global Investors PlanSuccess Certification Program.
[4] Benartzi.
[5] CFO Research Services. *Getting Retirement Savings Back on Track Employer Views on the 401(k) and Financial Education in the Workplace*. 2009.

Trait 3: The Hedgehog Concept

Walgreens built their success on the foundation of being convenient. For example, they only added new stores in convenient locations; also, they were the first drugstore to adopt online prescription refills in the early expansion of the internet. "Convenience" was what Jim Collins referred to as Walgreens' "Hedgehog Concept;" just like a hedgehog is associated with one particular strategy – rolling into a ball to defend itself from predators - great companies return to one core strategy time and time again in order to become the best in the world at it.

A winning retirement plan is a result of careful and deliberate decision making. At its most basic form, your retirement plan "hedgehog concept" – your corporate retirement philosophy – identifies whether your retirement plan exists because:

1. You have to have it to stay competitive in your industry; or
2. You want to have it to see your employees through to a secure retirement.

Your advisor should be able to guide you through some basic questions to establish your corporate retirement philosophy if your team is unsure or having trouble coming to an agreement. Great plans delineate a philosophy that is more about their employees and less about having a competitive benefits package. Some examples are:

- **Employee Experience**: Making your retirement plan easy to use and accessible
- **Education**: Ensuring employees understand how their 401k is part of a comprehensive financial wellness strategy
- **End Result**: Getting employees to retirement, at which point they'll turn over fund management to an advisor; or getting them "through" retirement by offering the right mix of financial products within the plan

Trait 4: The Stockdale Paradox (or... Confront the Brutal Truth)

Great organizations confront the brutal truth head on. They establish "red flag" mechanisms – processes for raising concerns and problems to the highest level.

One such brutal truth in your retirement program is fee transparency. New fee disclosure regulations that have been established forbid you from entering into any contracts with plan sponsors, advisors, and other service providers without establishing that the services are necessary and the fees are reasonable.

Because the DOL has determined that excess fees can greatly reduce participant account values at retirement[6], a great retirement plan will commit to utilizing tools and resources to stay in compliance with the letter and spirit of these new regulations.

[6] "5 Characteristics of a Great 401(k) Plan," by Michael Chamberlain, Forbes.com, 5/31/2011

Great plans will:

- Benchmark the fees, services, and features of their plan against similarly situated peers and service providers;
- Determine whether plan service providers' services are necessary; and
- Evaluate whether compensation for services is reasonable.

It is not prudent to receive this information solely from plan service providers or brokers that receive commissions, as these individuals have an obvious conflict of interest in reviewing their own fees. Also, third party surveys provide information on industry averages, and would not provide adequate information in determining whether or not the fees that are specific to your plan are reasonable. Therefore, the "red flag" process taken by great plans includes retaining the services of an independent, objective specialist to verify and confirm that fees are reasonable.

The other brutal truth is that the majority of plan participants are simply not on track to have a secure retirement. Industry averages demonstrate that the typical 401(k) participant has a low account balance, inadequate savings rate, and a general lack of knowledge and understanding regarding investing for the future. The remaining From Good to Great concepts demonstrate how you can confront this brutal truth with a culture of discipline, how to use technology accelerators, and why you should consider implementing a number of automatic features known as "The Flywheel."

Trait 5: A Culture of Discipline

As great organizations will fanatically adhere to their "hedgehog concept," great retirement plans will stick to their corporate retirement philosophy. And, if your plan has adopted a philosophy to have a plan because you want to have it, and because employees are at the focal point of all plan decision making, you're going to want to involve them in the process.

Take the recent case study of one particular manufacturing client in Pennsylvania, where just 44% of their 1500 employees were participating in the company 401(k) plan. The committee debated implementing an automatic enrollment feature to help participants start saving, and weren't sure how it would be received by employees. They conducted a series of employee focus groups over the course of two months, where the importance of retirement savings and the concept of automatic enrollment were introduced. With positive feedback from their employees, the committee approved automatic enrollment, and immediately bumped their participation rate to 87%. Using focus groups and surveys are great ways to gather employee appreciation and buy-in to your retirement plan strategies.

But demonstrating a culture of discipline in your retirement plan is not only about what you are doing for your participants; it's also about what you need to stop doing.

First and foremost, plan sponsors need to review their loan provisions. Retirement savings plans are established for just that – retirement. By offering multiple loans, participants may begin to treat their plan savings as they do their checking account, which puts them at a significant disadvantage as their outstanding loan dollars are missing out on the opportunity for growth and compounding interest. Remember, other types of loans are offered for home ownership, college, and other big life events – but there is no loan available to get your employees through retirement.

Great retirement plans will also optimize the company matching formula if one exists. It's important to note that great plans don't necessarily need a match; however, these plans should focus on plan design and education strategies that help their employees get to a personal savings rate of 15% instead of the 10% recommended in those plans that contain a matching formula. Participants tend to migrate to the deferral percentage where they receive the full company matching contribution. For example, the most popular match formula is 50% up to the first 6% deferred[7]. This formula can be changed to 30% up to the first 10% deferred with no substantial increase in cost to the employer. Participants would still get a 3% match, but they would need to defer 10%. (This formula may limit some HCEs in maximizing the match they receive due to nondiscrimination testing, but this can be addressed by way of a Nonqualified Deferred Compensation Plan). A recent study by The Principal demonstrated that stretching the match formula in this way did not have any negative impact on overall plan participation rates[8].

Another area for improvement is to look at the number of investment options offered by the plan. During the "First Who, then What" phase of building a great retirement plan, you should have identified the right mix of asset classes and investments for your plan. Having too many options may confuse participants, as most individuals do not have the proper financial background and education to select their investment options appropriately. Having seven funds, in addition to your asset allocation or target date fund options, is a healthy target; having more than nine funds could result in the individual either allocating their savings across the entire spectrum of investments, picking only one investment that may not be suitable, or avoiding the retirement plan completely.[9]

Finally, stop offering meetings focused solely on enrollment. With automatic features now readily available by plan sponsors, save yourself (and your employees) time – and in many instances, money – by directing meetings towards other financial education endeavors.

Trait 6: Technology Accelerators

Firms that embraced technology in new and creative ways differentiated themselves from their competition, and yielded great results.

Bringing technology to your retirement program can make a difference for your employees; and with the astounding speed at which innovation is taking place, you can offer more to your eligible retirement plan participants than simple web access to account balances.

[7] Vanguard 2012 How America Saves
[8] The Principal Financial Group. "New Data Reveals Power of Employer Match." November, 2010. http://www.principal.com/about/news/2010/ris-match-stats113010.htm
[9] Benartzi.

Many service providers have deployed mobile apps that allow participants to easily check their balances, calculate retirement income, and learn more about their retirement savings options. These providers also generally offer education and communication through text messages, giving employees who don't necessarily work at a computer all day or have smartphone capabilities the chance to receive timely information right in their pocket. The most successful education and communications programs offer simple ways for employees to understand and take action – where and when they are ready to do so.

The social networking influence of Facebook and Twitter has spilled over into the workplace, with enterprises utilizing internal tools such as SharePoint and Yammer to improve efficiency and education[10]. Plan sponsors should adopt social media within their strategy to educate participants about what their retirement program can do for them and broadcast general plan information. The ability to easily tag and share information of value within these tools can create an identity shift within your employees' attitudes towards the retirement plan. If understanding and contributing to the plan is seen as the social norm – the "cool" thing to do – you can expect participation and savings rates to improve.

An added benefit of using interactive websites, mobile apps, and social media is that these methods appeal to younger employees[11], who are at the prime period in their lives to begin accumulating retirement savings, but may choose to delay contributing to the plan in lieu of other priorities.

Trait 7: The Flywheel

Implementing the concepts detailed throughout this whitepaper builds momentum for your retirement program, just as a flywheel provides energy for a mechanical system. Jim Collins identified the flywheel as a perfect analogy for the energy behind the organizations that made the leap from good to great. The flywheel is heavy and slow-moving at first; but with continued, deliberate application, it keeps the system going.

Great retirement plans understand that individuals are hindered by inertia – but, much like a flywheel, that very same inertia can help employees realize their retirement goals. These plans heavily utilize automatic features (Table 1).

[10] "Microsoft SharePoint: Three Sleek Social Networking Alternatives," by Shane O'Neill, CIO.com, 2/4/2010
[11] "Retirement Programs Keep Employers on Track," by Gail Belsky, CNBC.com, 6/22/2012

Table 1

Feature	Description	Results
Automatic Enrollment	Employee will be enrolled and begin to save at a rate determined by your retirement benefits team, without needing to take any action.	Participation rates in plans with auto-enrollment features are around 90%, compared to 70% with traditional plans.[12]
Contribution Escalation	Every year, employee's deferral rate will automatically increase by 2% (or other rate specified) until it reaches a maximum specified by your retirement benefits team.	Plans which automatically escalate a participant's savings rate annually yielded dramatic results (average increase of 3.5% to 11.6% over the course of 28 months[13].)
Automatic Rebalance	On a quarterly or annual basis, employee's investment mix will be rebalanced according to their initial desired allocation, taking advantage of the well-known strategy to "buy low and sell high," without the employee needing to take action. Single target date funds generally rebalance within their own allocation.	401(k) participants receiving some type of assistance with rebalancing, either through advice or specialized retirement funds, raked in annual returns during 2004-2006 that were about 3 percentage points higher than the returns of do-it-yourself investors.[14]
Retirement Income Solutions	Great plans offer options to retirees to make it easy to drawdown their savings at an appropriate rate in retirement. Currently, 16% of plan sponsors offer an option such as an insurance product, a managed account with a drawdown feature, or a managed payout fund, while 22% of sponsors plan to add one of these features in the future.[15] For plans that do not offer one of these features, offering an automatic payment option over an extended period of time with online income modeling tools will help employees set a plan for receiving retirement income.	Adding a guaranteed minimum withdrawal benefit for life to a target-date fund could, for a typical 401(k) plan participant, reduce the amount of assets needed to generate a given amount of retirement income by 36%.[16]

[12] *Ibid.*
[13] "Save More Tomorrow – Research Highlights from the University of Chicago Graduate School of Business," by Richard H. Thaler. Capital Ideas; Vol 4-1. http://www.chicagobooth.edu/capideas/summer02/savemoretomorrow.html.
[14] "A Supreme case for saving your 401(k)," by Janice Revell, CNNMoney.com, 3/6/2009
[15] Hewitt 2012 Hot Topics in Retirement
[16] Prudential Financial. "What Employers Lose in the Shift from Defined Benefit to Defined Contribution Plans… and How to Get it Back." July 2011, p. 9 http://research.prudential.com/documents/rp/What_Employers_Lose_in_the_Shift.pdf

Moving Your Plan Towards "Greatness"

It is not difficult to move the needle on your retirement program towards greatness. With the uncertainty of Social Security, the diminishing presence of defined benefit plans, and the lingering shock over the market volatility of the past few years, you – and more importantly, your employees – cannot afford to have a less-than-stellar retirement program. Disciplined people, disciplined thought, and disciplined action will foster the positive change you desire for your plan.

If your program is missing any of the characteristics of a great retirement plan, it's time to consider working with an independent advisor who is an expert in fiduciary governance processes, retirement plan design, and communication and education strategies to see how you can apply the above elements to achieve results. Check out www.mfpstrategies.com for additional resources on achieving retirement plan greatness.