

# 7 attributes of an excellent DC plan



“How does our retirement plan compare to others?”

This is a common question when an organization evaluates key characteristics of its defined contribution (DC) retirement plan. Plan sponsors and their advisors often benchmark their plans against industry averages to see how they measure up. But, is that what they should strive for – being average – or should they aim higher? At Russell Investments, we believe DC plans should strive for *excellence*.

Consider that a company with 1,000 DC plan participants spends \$3 million annually on DC employer matching contributions.<sup>1</sup> That’s a big spend! It’s no surprise that plan sponsors often worry about how to get their employees to better appreciate the value of their DC plan.

Excellent DC plans are valued more by employees than average DC plans. And, in many industries, the competition for talent is fierce and excellent DC plans can make better workforce management tools than average DC plans<sup>2</sup>.

American workers need DC plan excellence now more than ever. Today, a DC plan often serves as the primary source for retirement savings, but changing work habits can put a damper on savings. The gig economy is booming and a career is no longer a defined path, rather, it’s more of a jungle gym. Russell Investments has quantified the impact of frequent job changes and has found that it can result in significantly less retirement savings accumulation.<sup>3</sup>

The DC market isn’t known for embracing rapid innovation, but you don’t have to in order to offer an excellent DC plan. Excellence is taking the extra step on what you’re likely already doing – small incremental changes that can yield big results. Heightened fiduciary sensitivity to litigation and regulatory risk should not be a barrier to becoming an excellent DC plan. While there still is a need to periodically evaluate and benchmark the plan, these prudent actions need not lead to a retirement plan committee mindset of striving for average. Here are the key attributes that excellent DC plans are implementing and the actions you can take to make sure your plan is positioned for excellence.

## Attribute #1 – A retirement income mindset

### Establish and measure the right objective

#### Average plan

Average plans often define success as achieving a high participation rate. Automatic enrollment has been very successful, and today most plans report participation rates of 90% or higher. Plan participation is important, but it is not enough. Average plans monitor how much participants have saved, and report current account balances to their participants each quarter. The average 401(k) plan balance is around \$86,000.<sup>4</sup> While most plan sponsors and their employees know that isn’t enough, even if the average account balance at a company is significantly higher, how do participants know whether they are saving adequately when account balances alone don’t tell them where they stand in terms of their retirement readiness? Imagine packing for a vacation without knowing your destination. Participants who focus only on accumulation are faced with that issue.

#### HOW DOES RUSSELL INVESTMENTS 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 Investments, we believe excellence 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 to improve the chance that their participants will achieve a secure retirement.*

## Excellent plan

Excellent plans' primary objective is to establish participant income replacement in retirement. They design the plan around meeting that objective, and monitor their participants' progress by periodically conducting a replacement income study. They provide gap analysis or a statement with retirement income projections as a standard part of their reporting to participants. They help participants determine what their savings rate should be by establishing a replacement income target and guiding participants toward the savings rate necessary to meet that target, reporting their progress in terms of income replacement rather than account balance.

### Action items

- Establish income replacement as the DC plan's objective. Develop a Target Replacement Income (TRI) goal for the plan and design the default and company match rates with this TRI in mind.<sup>5</sup>
- Monitor success with periodic replacement income studies conducted by your recordkeeper, consultant, or fiduciary provider.
- Use the results to make targeted plan design changes or provide targeted participant communications to address shortcomings.
- Work with your recordkeeper to enhance your plan's statements so they place the focus on retirement income and not on wealth accumulation.

## Attribute #2 – A thoughtfully designed plan menu

### Reduce the number of complicated investment decisions for plan participants

#### Average plan

The trend in the 1990s was to offer multiple investment options in a DC plan – some plans even offered as many as 100 options. While great strides have been made since then among many plan sponsors to streamline the number of plan menu options, the average plan still offers 17 Tier II, or mainly single-asset-class offerings. Average plans think about streamlining the plan menu in terms of eliminating redundant options.<sup>6</sup> Instead, they should consider the number of decisions participants are asked to make. Average plans maintain a “Morningstar style box” mentality of offering a patchwork quilt of options to fit every investment category. That leaves participants in the average DC plan with five complicated investment decisions to get a diversified asset allocation in the Tier II menu: 1) Equities or Bonds 2) Domestic or International 3) Large, Mid or Small 4) Growth, Value or Core 5) Active or Passive.

## Excellent plan

An excellent plan identifies the investment decisions the Committee or its professional investment managers will make on behalf of participants, and the investment decisions that their participants will retain. The plan menu is designed accordingly.

### Action items

- Identify the number of investment decisions the typical plan participant (who is not invested in the plan's default option) needs to make to arrive at an age-appropriate, diversified asset allocation.
- Consider offering a limited number of broad multi-manager and multi-style funds as core options.
- Consider giving the funds descriptive names that help participants use them appropriately (i.e., an asset class name).
- Consider offering a brokerage window to provide more choice for the minority who desire that level of involvement.

## Attribute #3 – Majority of plan assets in a professionally managed asset allocation solution

### Take advantage of participant inertia

#### Average plan

The typical plan has just 33% of plan assets in the plan's default option, and a handful of participants using a managed account.<sup>7</sup> Also, many participants don't appear to have an appropriate asset allocation relative to their years until retirement. The average plan has instituted automatic enrollment into the plan's default option for newly hired participants. However, the average plan hasn't nudged existing participants into age appropriate asset allocations by using automatic re-enrollment into the plan's default option.

#### Excellent plan

Excellent plans have 60%+ of participants in an asset allocation strategy (target date, balanced or managed account). This is the minimum allotment we see in plans with participants who are defaulted into such strategies upon automatic enrollment and re-enrollment. Many plan sponsors have embraced asset allocation default solutions for new employees. Excellent plans have also realized that legacy participants' investment allocations may not be the most appropriate, and conduct a plan re-enrollment into the plan's default option, sometimes every few years. Finally, since most of the assets either are now, or will be, held in the default option, excellent plans are also taking default investing to the next level by including institutional quality investment solutions and providing glidepath customization or individually managed accounts as their plan's qualified default investment alternative (QDIA).

#### Action items

- Consider an automatic QDIA re-enrollment campaign, giving both short- and long-tenured employees the same opportunity to benefit from the diversification and age appropriate asset allocation delivered by the plan's default option. Offer this re-enrollment during your open enrollment cycle to capture your participants' full attention.
- Evaluate your plan's current default option and consider opportunities for enhancement. Ensure your plan's default options align with the retirement income replacement needs of participants.
- Consider whether a customized target date fund or managed account solution can provide additional benefits beyond a one-size-fits-all target date option. The benefit of offering a managed account in place of a target date fund is that, instead of only placing participants in a national average, one-size-fits-all vehicle, specific information, such as age, gender, contribution rate, and account balance can be used to create an asset allocation that is more customized to them, and adjusted for changes in capital markets and some of the participant's unique circumstances.

### Attribute #4 – Double-digit contribution rates

#### Give participants the best chance of success

##### Average plan

Savings rates are the single largest determinant in keeping participants on track for a successful retirement. Average plans benchmark their savings rates to industry averages, which at 7.2% are too low.<sup>8</sup> Average plans provide a company match, but expect participants to determine an appropriate savings rate themselves, and increase their savings rates as their salaries increase over time. Average plans worry that automatically increasing participants' savings rates over time will lead to higher opt-out rates, although the data do not support this concern.

##### Excellent plan

Excellent plans take their cues from the multitude of industry sources that recommend savings rates should be in the neighborhood of 15-17%.<sup>9</sup> Or, ideally, their savings rates will be guided by the TRI goal, per Attribute #1. Excellent plans will use many tools to help achieve this goal, including opt-out automatic escalation, stretching the company contribution formula to incentivize higher savings rates to achieve the full company match, and retirement income projections for participants.

##### Action items

- Determine a targeted savings rate. Structure the company contribution formula (i.e., instead of matching \$0.50 on the first 6% of participant contributions, match \$0.25 on the first 12% to encourage a total contribution rate of 15%), provide a choice of default options and plan communication around the default.
- Consider using tools such as higher default rates, opt-out automatic escalation in 2% increments, and automatic catch-up contributions to put participants on the path of successful savings behavior.

### Attribute #5 – Encourage retiring/terminating employees to keep their money in the plan

#### A win/win for the sponsor and the participant

##### Average plan

When employees retire or change jobs, their retirement plan assets often leave with them, rolling into IRAs or regular savings or investment accounts. But keeping assets in the plan may be better for the individual (for cost savings and professional management) and for the plan sponsor who benefits from a reduction in unit costs and money management fees that result from holding more assets in the plan. Average plans provide only the mandated tax notice disclosure to terminating participants, which focuses on removing money from the plan. Average plans are often hesitant to provide additional information about the benefits of retaining assets in the employer-sponsored system because of fiduciary liability or other concerns.

##### Excellent plan

An excellent plan seeks to increase retention of departing employees' plan assets and has initiated programs to encourage retention. An excellent DC plan works with its recordkeeping vendor to set boundaries and guidelines on how the recordkeeper approaches retiring participants and the information they are provided.

##### Action items

- Provide educational communications to departing participants to help them decide what to do with their retirement assets. Inform participants about their ability to remain in the plan post-termination and the factual benefits of doing so.
- Plans may also wish to offer features that are more attractive to retirees such as lifetime income options, access to financial advice and the ability for terminated employees to take partial withdrawals from the plan and repay loans.

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## Attribute #6 – Provide post-retirement options

### Help your participants spend appropriately in retirement

#### Average plan

Retirement income is a hot topic among DC sponsors and providers, but most plans offer little in the form of tools and products to help retirees manage distributions. Average plans construct their DC plan menus solely for asset accumulation. In fact, the most common “post-retirement” solution offered today is a target date income fund. Average plans also lack retiree-friendly design features, such as allowing partial withdrawals for terminated participants.

#### Excellent plan

Excellent DC plans are designed for current employees, “alumni,” and retirees. They offer retiree-friendly investment options, tools, advice, and plan design and documentation to help participants make the transition from working to retirement. A leading-edge solution to providing options for retirees is a plan menu design enhancement commonly called the “Retirement Tier.” This is an additional tier on the DC plan menu specifically designed for retirees and near-retirees that offers tools, advice and investment options in one place.

#### Action items

- Consider if your plan menu offers enough tools (i.e., social security optimizers, retirement calculators), communications (i.e., catch-up contributions) and post-retirement investment options (i.e., income, managed payout, laddered bond funds, insurance solutions, inflation protection) for participants planning for retirement or who wish to remain in the plan post-retirement. Do plan provisions allow for things such as partial withdrawals and loan repayments for former participants? Begin incorporating investments and tools targeted toward retirees and pre-retirees.
- Consider formally designating a Retirement Tier on your DC plan menu.

## Attribute #7 – Integrated financial wellness

### Focus on changing behavior

#### Average plan

Though often used interchangeably, financial wellness and retirement education are different concepts. Financial wellness goes far beyond retirement, and intends to effect behavioral change rather than simply educate. The goal of many financial wellness programs is to guide employees to financial success and security at all stages in their lives by promoting action through personalization, coaching and strong employee engagement. Average plans focus more narrowly on retirement investment or savings concepts. Some may offer basic financial education, commonly through a complementary recordkeeper program that offers employees links to educational collateral.

#### Excellent plan

Excellent plans offer a more comprehensive financial wellness program designed to do more than “educate” employees about finance. They apply lessons already learned on the traditional health benefits and wellness side of the organization, where the need for engagement and motivation to make behavioral change is already generally acknowledged (i.e., weight loss, smoking cessation). Excellent plans understand that financial wellness programs can improve the value of the plan for employees, and use financial wellness to raise awareness and appreciation of company benefits across the board.

#### Action items

- Not all financial wellness programs are created equal. Offer a financial wellness program that helps employees work toward financial health in all stages of their lives. Apply the concepts and principles of effective behavioral change that are likely already being used for health wellness. Make sure accessing your financial wellness program is quick and painless, and seek to make it an enjoyable and motivating experience.

## Conclusion

We strive for excellence in every aspect of our lives. This article highlights the fact that excellent DC plans do not happen by accident; it takes a process starting with the end in mind, as well as the 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.

## Exhibit 1: 7 attributes to an excellent DC plan

ATTRIBUTE	AVERAGE PLAN	EXCELLENT PLAN	CORRECTIVE ACTION
<b>1. Retirement income mindset</b>	Focuses on participation rates and account balances	Has embraced a retirement income mindset	Set the 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.
<b>2. A thoughtfully designed menu</b>	Trims options at the margins	Thinks about how many decisions a participant is asked to make and designs menu accordingly	Consider offering a limited number of broad multi-manager and multi-style funds as core options. Also, consider offering a brokerage window to provide more choice for the minority who desire that level of involvement.
<b>3. Majority of plan assets in a professionally managed asset allocation</b>	Instituted automatic enrollment into plan's default solution for new hires but not for existing participants	Conducts plan re-enrollment into the plan's default solution for existing participants; automatic enrollment for new participants; enhances existing default investment	Consider an automatic re-enrollment into the plan's QDIA for existing participants. Evaluate your plan's current default option and consider opportunities for enhancement such as a managed account offering or a customizable target date solution.
<b>4. Double-digit contribution rates</b>	Benchmarks contribution rates to industry average	Uses many tools to help increase participation rates including automatic escalation, stretching the company contribution formula to incentivize higher savings rates to achieve the full company match, and retirement income projections for participants	Determine a targeted savings rate. Structure the company contribution formula, provide choice of default option and plan communication around this idea. Consider using tools such as higher default rates, opt-out auto escalation in 2% increments and auto catch-up contributions to put participants on the path of successful savings behavior.
<b>5. Retain plan assets of retiring or departing participants</b>	When participants leave or retire, the retirement plan assets go with them; mandated tax notice disclosure is provided to departing employees	Initiates programs to encourage retention of plan assets when participants leave the company; works with recordkeeper on the information participants are provided	Provide educational communications to departing participants to help them decide what to do with their retirement assets. Provide features that are attractive to retirees such as lifetime income options, access to financial advice and the ability to take partial withdrawals.
<b>6. Provide post-retirement options</b>	Plans constructed for asset accumulation	Plan is designed for current employees, "alumni," and retirees; offers retiree-friendly investment options and tools	Begin incorporating investments and tools targeted toward retirees and pre-retirees. Consider formally designating a retirement tier on your DC plan menu.
<b>7. Integrated financial wellness</b>	Focuses narrowly on retirement investment or savings concepts; some may offer basic financial education	Offers a comprehensive financial wellness program designed to do more than "educate" employees about finance	Offer a financial wellness program that helps employees work toward financial health in all stages of their lives.

<sup>1</sup> Vanguard How America Saves 2018. Based on median participant income of \$67,000 and median employer match of 4.2%. Not inclusive of reduction in tax liability.

<sup>2</sup> Deloitte Defined Contribution Benchmarking Survey 2017

<sup>3</sup> The effect of job changes every four years could lead to a final accumulation at retirement that is more than 40% less than a full-career employee assuming typical defaults of employer of match 50 cents for each dollar contributed by the participant up to 6% and automatic contribution escalation of 1% per year up to a 10% cap.

<sup>4</sup> PSCA 59th Annual Survey

<sup>5</sup> For more information, see "What's the right savings rate?" Russell Research, updated August 2016

<sup>6</sup> Deloitte Defined Contribution Benchmarking Survey 2017

<sup>7</sup> Vanguard How America Saves 2018

<sup>8</sup> Vanguard How America Saves 2018

<sup>9</sup> Sources: Aon Hewitt The Real Deal 2015, (12% - 15%); Vanguard How America Saves 2016, (14%); Employee Benefit Research Institute (15%)

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