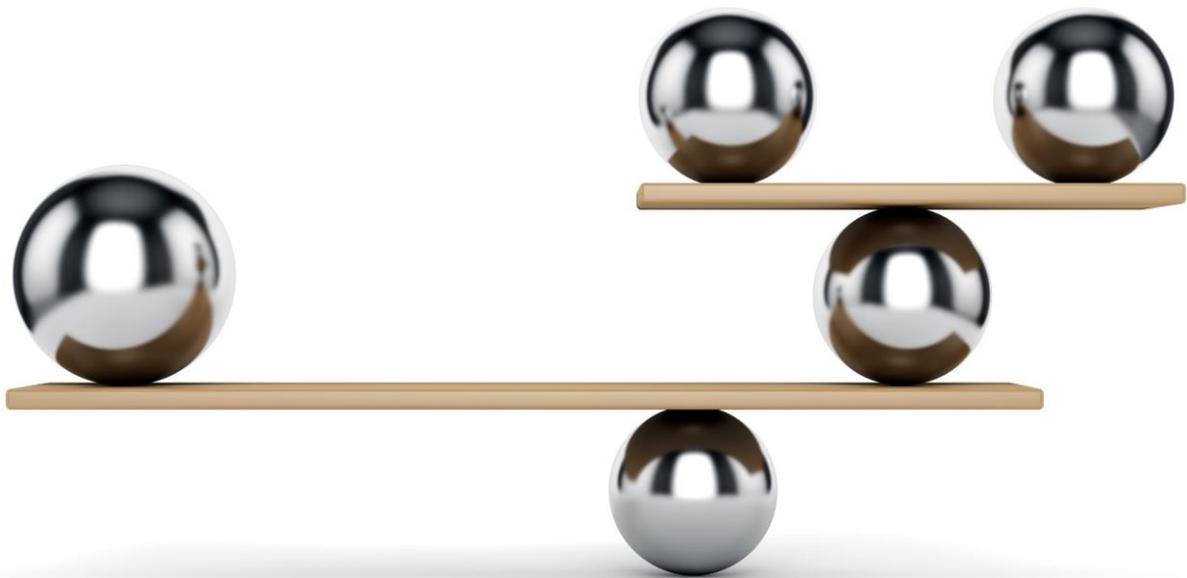




DC plan re-enrollment

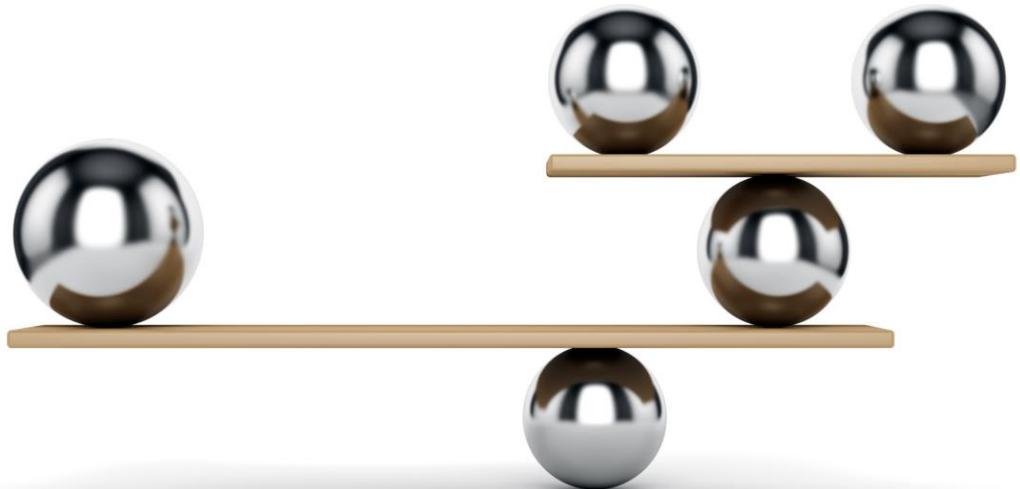


A fiduciary imperative?



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Defined contribution plan re-enrollment: A fiduciary imperative?

Holly Verdeyen, Head of Institutional Defined Contribution

In 2014, re-enrollment celebrated a major milestone with its tenth anniversary, officially marking a full decade since the first complete plan re-enrollment in a defined contribution plan was conducted in 2004. The plan sponsor was Helzberg Diamonds, the Kansas City–based diamond retailer owned by Warren Buffett’s Berkshire Hathaway, Inc. At the time, the well-publicized event was heralded as a sign of things to come for defined contribution plans.

A landmark decision for re-enrollment was achieved in 2006, when the process of re-enrollment into a qualified default investment alternative was granted safe harbor protection by the Pension Protection Act of 2006 (PPA). PPA included a number of other fiduciary protections as well, and it has been very effective in driving plan sponsors to embrace automatic enrollment and professionally managed asset-allocation solutions, such as target date funds. PPA did not, however, result in large numbers of plan sponsors taking advantage of the fiduciary protections granted to re-enrollment, and re-enrollments are still relatively rare.¹

This paper looks at:



1. The role a re-enrollment campaign can play in guiding all plan participants to an appropriate asset allocation



2. Common reasons cited by plan sponsors for avoiding re-enrollment, and counterpoints to each



3. Key elements of a successful implementation



4. Re-enrollment terminology

¹ 2019 Callan Investment Institute Defined Contribution Trends Survey

It's an all-too-common story: an investment committee invests significant time and effort in improving its DC plan's investment lineup. Committee members reduce the tier-2 stand-alone menu to a core offering of key asset-class funds. If it's a large plan, they may decide to move from retail mutual funds to lower-cost institutional vehicles, or may create multi-manager white-label structures. Most importantly, plan fiduciaries focus considerable attention on selecting or building the most appropriate qualified default investment alternative (QDIA) as is consistent with their plan's objectives and demographics. Most likely, these QDIAs will be target date funds that the plan will use to auto-enroll new employees.

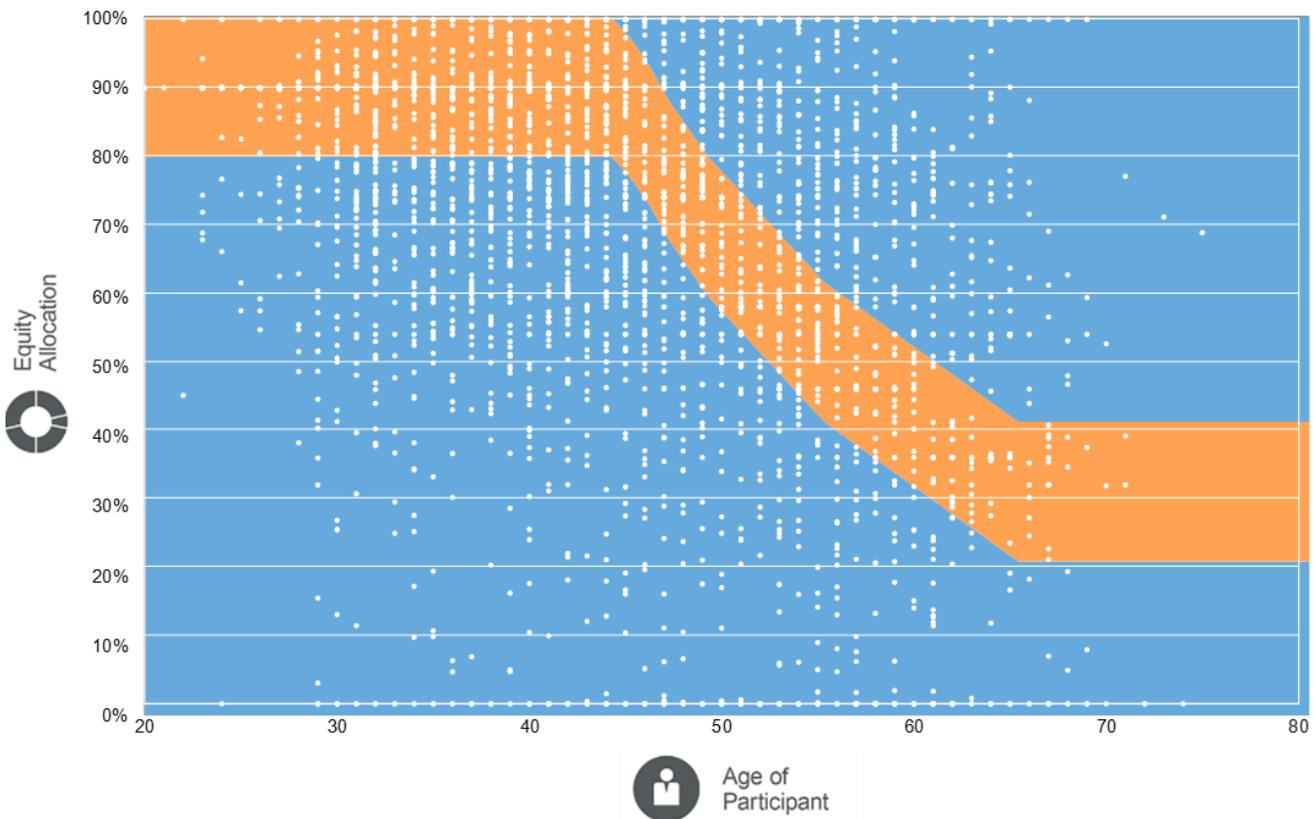
Then, after investing this time and energy in crafting a much-improved investment lineup, the plan fiduciaries decide to leave the assets of existing participants exactly where they were, maybe even letting participants keep their existing retail funds instead of mapping their assets to the new core institutional portfolios. Going forward, the new target date funds will be the centerpiece of the plan – essentially, embedded advice representing the investment committee's best thinking on age-appropriate asset allocation. Yet, unless the sponsor takes action, legacy employees will remain invested in their existing portfolios, which, if they are like those of most plans, will be severely misallocated.

The problem: Poor portfolio construction

Unless you've already taken corrective action, chances are that a great number of your plan participants have poorly constructed portfolios. Today, most recordkeepers are able to provide plan sponsors with data on individual participants' allocations to equity and other growth assets. Allocations are plotted against participant ages (Exhibit 1), with each dot representing a single participant. The orange band represents the glide path of a plan's target date funds, plus/minus 10%.² Given that target date funds typically serve as a plan's QDIAs – and we will assume that they have been selected with appropriate due diligence, and that they represent the philosophy of plan fiduciaries – the funds' glide path represents a proper allocation frame of reference for the plan. A participant in the band can be considered to have an age-appropriate asset allocation.

So what do such displays typically tell us? Russell Investments has evaluated them for a number of clients. Graphically, they all look the same – almost completely random. From our experience, it would not be unusual for two-thirds of participants to be “misallocated”: some retirees are

Exhibit 1: Allocation to growth assets by participant ages



Shown for illustrative purposes only., Source: undisclosed Russell Investments client

² 2019 Callan Investment Institute Defined Contribution Trends Survey

found to hold all-equity portfolios, while many 20-somethings have invested all their assets in bonds and cash equivalents.

Of course, some participants are “off-target” for good reason. For example, they may be working with financial advisors to incorporate outside taxable assets within an overall asset allocation, only a portion of which is visible to the plan. But unfortunately, this is the exception; the norm, as we know it, is that most DC plan participants pick their investment options on advice from, say, a brother-in-law who is “good with money,” or a coworker who happened to be sitting in the next cubicle when they first joined the company 12 years ago. No doubt the funds with the best recent performance were selected then, and it’s unlikely that the allocation has been touched since. Plan sponsors cannot be blamed for this result.

They simply followed the regulations and accepted the conventional wisdom – a foundational belief of the defined contribution retirement plan system – that through education, each and every participant could become an informed investor.

So, confronted with these realities, what is a plan fiduciary to do? More importantly, with knowledge of the poor portfolio allocation decisions made by many – possibly the majority – of your participants, are you compelled to act? Even if your legal counsel says you are under no obligation to do so, if other plans in your industry take action, will you risk potential litigation for not having kept current with prevailing best practices?

Safe harbor tested in court case

In *Bidwell v. University Medical Center*, the sixth Circuit ruled in June 2012 that plaintiffs, having received proper notice under QDIA requirements, failed to exercise investment direction and were properly moved into the plan’s default vehicle.

A solution: Plan re-enrollment

Over the past few years, complete plan re-enrollment has gone from a provocative to a more broadly accepted concept. (“Re-enrollment” is really a misnomer – more accurately, participants are simply given the chance to re-select their investment options.) No other single action provides as dramatic an opportunity to transform the investment experience of plan participants than a plan re-enrollment. And when it is done correctly, fiduciaries are given safe harbor protections through provisions of the Pension Protection Act of 2006 (PPA).

Here's how re-enrollment works

Plan participants are asked to re-select their investment options, typically via a special website established by the plan’s recordkeeper, only if they want to maintain their current elections or choose entirely new options. This process often takes place during a change in the overall investment menu or a change of recordkeeper, but it doesn’t have to.

Communications materials inform participants that if they fail to act after a reasonable notice period, all existing balances and future contributions will be mapped to the QDIA, which usually is an age-appropriate target date fund. These materials also explain the benefits of professional management of target date portfolios. This could also be an excellent time to auto-enroll all current employees who for any number of reasons have not yet joined the plan.

The process sounds quite straightforward. So other than lack of awareness of the PPA safe harbor protections provided to fiduciaries who take this course of action correctly, what’s holding plan sponsors back?

PPA safe harbor protections

Whenever participants are given an opportunity during an adequate notice period to make an investment decision and they fail to act, their assets may be defaulted into the plan’s qualified default investment alternative (QDIA).

The roadblocks

In 2018, more than 85% of plan sponsors had not conducted a plan re-enrollment,³ and several reasons are commonly cited for not doing so. We provide counterpoints to each.

1. We have not conducted a re-enrollment because of the perceived fiduciary risk

Fiduciaries are protected against liability for investment outcomes when defaulting participants into the plan’s QDIA. The regulation clearly states that participants who are given the choice to make an investment election, but fail to do so, may be mapped into the plan’s QDIA, and the sponsor will obtain safe harbor relief from fiduciary liability for investment outcomes, provided certain conditions are met.⁴ It’s the same safe harbor that plan sponsors avail themselves of when they auto-enroll participants into the plan, so a full plan re-enrollment should not be viewed by fiduciaries as being any more risky than automatically enrolling newly hired employees into the plan and defaulting them into the plan’s QDIA. A consultation with a legal professional versed in ERISA should be sufficient to calm any plan sponsor’s fears about fiduciary risk.

³ 2019 Callan Investment Institute Defined Contribution Trends Survey

⁴ QDIA notice requirements: ERISA §404(c) (5) and ERISA Regulation §2550.404c-5. Notice of blackout periods: ERISA §101(i) and ERISA Regulation §2520.101-3.

Exhibit 2: A client case study

Cruise line operator

RE-ENROLLMENT DATE	PARTICIPANTS	TOTAL PLAN ASSETS	AVERAGE ACCOUNT BALANCE
10/1/2015	2,700	\$85.9M	\$35,000

PRIOR PARTICIPANT INVESTMENTS	QDIA ROLLED INTO	BEFORE RE-ENROLLMENT	AFTER RE-ENROLLMENT
Included 18% in money market and stable value which was reduced to 3%	Target date fund	1% in QDIA	92% in QDIA

For illustration purposes only. Results may not be typical of all plan re-enrollments. Actual results may vary.

2. We have not conducted a re-enrollment because we fear negative participant reaction.

Many plan sponsors prepare for the worst when making any change to their defined contribution plan, whether by replacing an investment option or transitioning to a new recordkeeper. Often, however, the actual experiences of many plan sponsors reveal that their fears were largely unfounded. The telephones of the call center don't ring off the hook, nor do their email inboxes overflow with complaints from disgruntled participants. Furthermore, we have found a growing body of research indicates that many participants strongly prefer their employers to be much more involved in guiding them to appropriate investment decisions.⁵

There is a tendency to chalk up the lack of participant reaction to the fact that participants are not engaged. Certainly some are not, either by choice or due to plan design, but perhaps another reason participants don't react negatively to re-enrollment is because they are, in fact, pleased with the actions of their employer. A re-enrollment can serve as a gentle reminder to participants that their employer is looking out for their best interests and has their financial well-being in mind.

Further, a complete plan re-enrollment need not be disruptive to participants. If participants prefer to maintain their current asset allocations, or select new allocations themselves, they simply indicate that preference, and their assets will not be altered. In most instances, only participants who chose to be re-enrolled, or who fail to make a decision, will have their current account balances and future contributions re-allocated into the plan's QDIA.

3. We have not conducted a re-enrollment because it will be too much work.

It's understandable that a plan sponsor could assume that a re-enrollment would result in a landslide of extra work. After all, it has the potential to impact every single participant in the plan. But speak to plan sponsors who have conducted re-enrollments and they will likely tell you that the burden on them and their internal staff was manageable, and well worth the effort. The plan sponsor's primary responsibilities are generally limited to decisions about key dates, selecting the qualified default investment alternative, and working with the recordkeeping provider to ensure that notice requirements are met. There is only one participant notification required by ERISA in order for plan fiduciaries to obtain the QDIA safe harbor protection: a notice to participants **not less than 30 days** in advance of the re-enrollment, that meets specified notice requirements,⁶ essentially notifying participants to make investment elections or otherwise have their current assets and future contributions directed into the plan's QDIA. An annual notice must also be provided to participants who were defaulted, stating that their assets were invested in the plan's QDIA and that they can make a new investment election at any time.

However, the benefits of a well-executed communications strategy cannot be underestimated when it comes to maximizing the effectiveness of the re-enrollment. Our experience has shown that additional re-enrollment communications, provided before and after the required 30-day participant notice (such as re-enrollment brochures, newsletters and final reminders), can serve as a "drip" campaign to participants and ensure that they are well informed in the period leading up the re-enrollment date. Your providers most likely have experience managing re-enrollment timelines and communication campaigns.

⁵ "Nudge: Improving Decisions About Health, Wealth, and Happiness" by Richard Thaler and Cass Sunstein (Yale University Press, 2008).

⁶ See footnote 4

4. We have not conducted a re-enrollment because we don't feel the need.

The traditional metrics of plan success, such as participation rates or deferral rates, are not relevant to the re-enrollment decision. The only way to determine whether a re-enrollment is needed is to review data on how participants are invested, which can be obtained from the recordkeeping provider. A good rule of thumb is to use the glide path of your target date fund as a benchmark for age-appropriate asset allocations, as displayed in Figure 1. If the majority of participants fall outside a range of appropriate asset allocations as measured by the glide path (i.e., +/- 10%), then you may conclude that most participants are misallocated and a re-enrollment is needed. Even for participants who opt out of the re-enrollment, the exercise is a good reminder to revisit their asset allocations.

Successful implementation

Here are three suggestions for an effective re-enrollment implementation.

1. OVERCOMMUNICATE

Take the time and invest the energy to clearly communicate the process and avoid unnecessary confusion. Provide an adequate notice period to comply with QDIA regulations and maintain safe harbor protections. Documentation of the notice process is critical for legal protection. There will always be a few vocal critics of any plan change, but effective communications can limit their numbers.



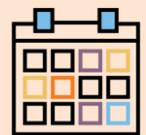
2. SELL THE BENEFIT

Strike a positive tone. No apologies are required – re-enrollment is a great opportunity and benefit! The focus of participant communications is changing from attempting to convince employees to take action to explaining the value of the steps taken by their employers on their behalf. Promote the benefit of professional management via target date funds or other QDIAs. Point out the challenges many participants encounter in building, monitoring and rebalancing their own portfolios.



3. MAKE RE-ENROLLMENT AN EVENT

A recordkeeper change, plan merger or major redesign of an investment lineup may suggest a natural time for re-enrollment. But you don't need to wait. A plan re-enrollment is enough of an event on its own. Promote and celebrate it.



Re-enrollment terminology – Would it be beneficial to re-brand re-enrollment?

As indicated earlier, the term “re-enrollment” is an inaccurate description for the corrective action, described in this paper, of re-allocating the 401(k) assets and future investment elections of currently enrolled participants into the plan's QDIA, unless they take action to re-select their investment options before a specified date. In fact, a re-enrollment has nothing to do with enrolling participants at all, but rather in re-allocating the assets and future contributions of existing participants who have already made an investment election.

Further adding to the confusion, the term “re-enrollment” is similar to the term “automatic enrollment” (automatically enrolling all non-participating, eligible employees into the QDIA), so the two terms are easily confused. For clarification: while automatic enrollment places new participants into the plan's QDIA, the assets of existing participants, whose portfolios were often chosen years ago, remain misallocated.

To quote the philosopher Confucius: “The beginning of wisdom is to call things by their proper name.” Could re-enrollment gain more traction if we gave it a proper name that more accurately describes the process? There are several suitable substitutes for the term – investment re-election, investment re-set, plan re-mapping, plan refresh – but perhaps the term that most accurately describes the action is plan reallocation. As a matter of practicality, aside from being more illustrative, the noun reallocation, a noun (e.g., “Our plan conducted a complete reallocation in 2012”), suggests verb forms as well (e.g., “Acceptance was widespread when we reallocated participants into the plan's QDIA last year”). Rebranding re-enrollment as reallocation is a small step that may promote better understanding and, hopefully, greater adoption, of the practice.

Conclusion

Evidence is building in support of the observation that the self-directed, do-it-yourself approach to DC investing is resulting in poorly constructed participant portfolios. We believe the tool to remedy this problem is a timely complete plan re-enrollment (reallocation), and fiduciaries have been provided a safe harbor for performing this activity. Yes, the percentage of plan sponsors who have taken advantage of a complete plan re-enrollment to guide participants into properly constructed portfolios remains lackluster, but we believe that as more evidence is gathered on the effectiveness of re-enrollment, and of the lack of participant reaction that accompanies it, an increasing number of plan sponsors will feel compelled to act. Aside from taking steps to increase overall plan participation and contribution rates, no other single action offers plan sponsors as great an opportunity for positive impact on retirement outcomes as does offering participants the opportunity to re-elect their investment options via a re-enrollment.

Positively impact your DC participants' retirement outcomes by re-enrolling them in your well-designed qualified default investment option.

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Important information

Additional author: Dick Davies

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