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Financial Services

The value of advice in a retirement plan

A way for plan sponsors to improve retirement readiness

If you're a plan sponsor, chances are that in the last year or two you have done something to improve participation in your organization's retirement plan. Maybe you initiated an e-mail campaign to encourage non-participants to begin saving — or to persuade existing participants to save more. Maybe you simplified an enrollment form, added an online educational video, or introduced an automatic escalation feature. You may have even increased the level of your employer match.

But have you considered the role advice and financial counseling can play in improving participation and ultimately your employees' retirement readiness? At a time when defined benefit plans are disappearing and the burden of preparing for retirement is falling squarely on workers' shoulders, advice on how to allocate plan contributions and otherwise take better advantage of the plan offered by an employer can push workers towards better-informed financial decisions. A recent survey found that, among people who seek financial advice, 52% act on that advice some of the time, and 32% act on advice all or most of the time.[1]

Seeking advice and taking action can increase workers' retirement readiness, and — once they've left the world of full-time work — can increase the odds that they'll have enough income to last them their whole lives.

Benefits of retirement advice at two universities

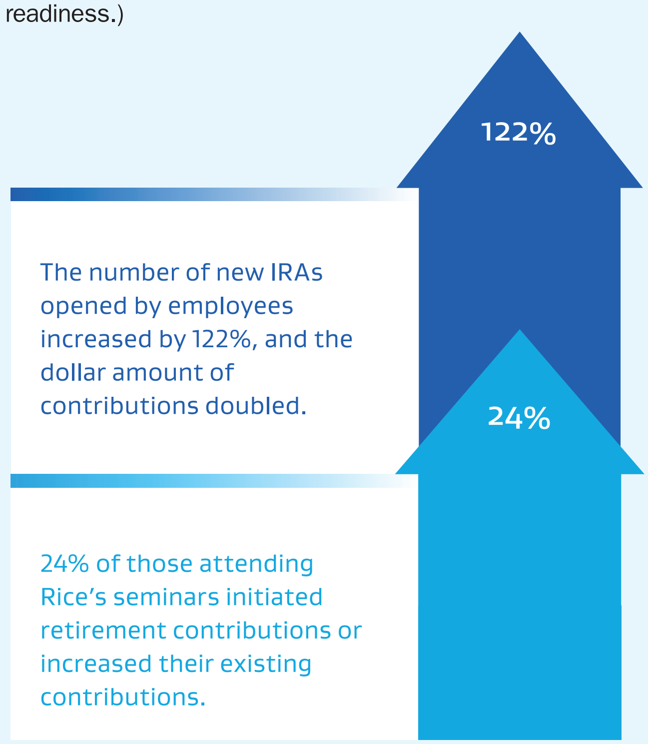
At both Rice University and the California Institute of Technology, benefits administrators weren't satisfied that employees were doing enough to prepare for their retirements.

Rice faced a language barrier. One-fifth of the employees were Hispanic, and many of those employees were most comfortable discussing their personal finances in Spanish. Administrators at Caltech also faced language barriers, but their biggest challenge was getting a diverse population of faculty and scientists (Caltech manages NASA's Jet Propulsion Lab) to focus on actions that would improve their retirement readiness.

Both universities started with comprehensive workshops and seminars to educate participants on the basics of retirement planning, with each tailoring its "pitch" to a specific constituency. At Rice, flyers were posted in Spanish, and Spanish-speaking administrators were enlisted to get staff to attend seminars. Caltech branded its program the "Science of Benefits," a metaphor designed to resonate with the school's technical faculty and staff. (Caltech also had marketing geared to female plan participants, who trailed male faculty and staff in retirement readiness.)

Both Rice and Caltech followed their initial high-level guidance with specific advice offerings. These were structured as one-on-one sessions in which TIAA-CREF, the schools' retirement-plan provider, gave employees concrete advice about asset allocation — providing specific fund recommendations for rebalancing existing portfolios and adjusting allocation of future savings — as well as integrated guidance on savings goals and starting or increasing retirement plan contributions.

The efforts worked. For instance, 24% of those attending Rice's seminars initiated retirement contributions or increased their existing contributions. Caltech participants also did more to prepare for retirement: Eighty-four percent of attendees reported that the workshop prompted them to take action. Participation in the main campus's optional supplemental plan increased 11%, contributions at other locations increased 7%, the number of new IRAs opened by employees increased by 122%, and the dollar amount of contributions doubled.



Is there a difference between advice and guidance?

Every plan sponsor communicates with its participants, giving them information about new investment options, reports on how their retirement funds are performing and, increasingly, online calculators that show participants the amount of money they can expect to have in retirement given their current patterns of saving and investing. This is generally considered education by the Department of Labor — otherwise known as "guidance." But combining advice with guidance can educate participants about their investment options while delivering recommendations in a holistic and engaging manner that makes it easy for people to take action that supports their retirement goals.

Understanding how guidance works is fairly straightforward: It generally consists of information and materials about, among other things:

- The benefits of participating in the plan and increasing contributions
- The impact of withdrawals on retirement income
- The terms and operation of the plan

It also can include asset allocation models and interactive investment materials that estimate future retirement income needs and assess how asset allocation will affect retirement income (if certain conditions are met).

By way of example, guidance may address:

- How to set a retirement savings goal
- How much of each paycheck to set aside for that goal
- How much and in what way to annuitize retirement savings
- How to match a retirement budget to an expected income stream
- How to establish a plan for both continuing to invest and to draw down savings in retirement

Such guidance may be delivered to a broad audience in printed material; to an individual via tools and calculators that allow plan participants to incorporate their own specific data and goals; or via a one-on-one consultation. Such guidance is very valuable — numerous studies have shown that engaging employees through targeted, relevant education can increase pension participation, savings rates and net worth[2] — and it can generally be offered without incurring fiduciary responsibility.

Investment advice, on the other hand, is considered a fiduciary undertaking by the advice provider. For purposes of the Employee Retirement Income Security Act (ERISA), the Department of Labor has established a five-part test to determine whether something is "investment advice": the advisor must (1) make recommendations on investing in, purchasing or selling securities or other property, or give advice as to their value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions, and (5) will be individualized to the particular needs of the plan.[3] Currently, a person or entity is treated as a fiduciary only if all five conditions are met. Note, however, that the DOL may soon seek to revise the definition of advice in a manner which could bring more personalized investment recommendations concerning plan assets into its scope.

Regardless of the technical definition of advice, its fundamental role is to provide recommendations that help participants make decisions about their plan assets. Advice should be prudent, sound and unbiased, and to ensure that is the case, advice is often provided by an independent source instead of the plan sponsor.[4] We believe it also should be based on generally accepted principles of portfolio theory, and the advice provider should adhere to its fiduciary responsibility to act in the best interests of plan participants. Finally, the advice provider should manage any conflicts of interest in accordance with ERISA and guidance from the Department of Labor.

Although advice and guidance are different, they work in tandem. A combination of guidance and advice can help educate the participant about plan investment options, establish a recommended asset allocation and then make fund-level recommendations on how to achieve that allocation based on available funds offered in the plan's fund line-up. Choosing an allocation strategy requires understanding savings goals and time horizons — and defining a plan typically requires making related decisions such as contribution increases and time-horizon adjustments. All of these factors work together as an integrated whole. So the combination of guidance rooted in a strong foundation of advice is essential to helping employees expand their perspective about the decisions they make, and take a more comprehensive approach to achieving the goal of retirement readiness.

One final and important note is the difference between a provider that offers advice and guidance versus one that only provides guidance. While the two may address

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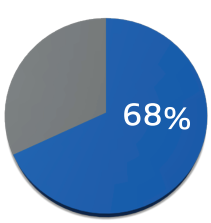
a seemingly similar set of topics, the retirement plan provider that offers advice (as defined by ERISA) should be prepared to take fiduciary responsibility for that advice, including providing unbiased recommendations on plan investment options that are in the plan participant's best interest. Providers of guidance are not currently subject to a fiduciary standard, but a plan sponsor's hiring of an education provider, like the hiring of an advice provider, is a fiduciary act that must be done prudently.

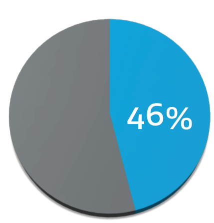
Advice's main benefits

Retirement readiness is probably the most useful objective for plan sponsors to focus on in considering the value of advice. Retirement readiness shows how much current income a participant is on track to replace in retirement. One common rule of thumb is that, in retirement, most people will need in the range of 70% to 90% of their pre-retirement income from all sources, including Social Security. If a calculation of their combined likely sources of income in retirement shows it to be within that range, participants are said to be "retirement ready." If the projected income replacement percentage is below that range, they are not retirement ready and it would make sense for them to consider changes in either their savings rate or the composition of their portfolios.

The problem is that plan participants can lack the motivation or the confidence to make needed changes on their own. Inaction, indeed, is endemic within the framework of retirement planning. Participants tend not to rebalance.



Approximately two-thirds (68%) of those who took advantage of TIAA-CREF's objective advice offering chose to either save more, revisit their portfolio allocation or rebalance their portfolio.



Among active plan participants, approximately half (46%) increased their savings rate.[5]

They can fail to increase their savings rates even when they can afford to do so. They may not reassess their short-term actions to meet long-term goals — if they have even set long-term goals (less than half have, according to research by the Employee Benefits Research Institute). Participants may be prone to "set it and forget it," to use a phrase that describes the many participants, who, upon joining a 403(b), 501(c), or 457 plan, pick a deferral rate and an allocation, and then don't think to revisit it for years. The result is often a level of savings that is far below what the participant can afford as his or her salary rises, and an allocation that is either too conservative or not sufficiently diversified. No wonder so few workers (only 14%) say they are "very confident" that they will have enough money to live comfortably in retirement.

We believe inaction is less of a problem at plans that have an advice component. Specific investment and security recommendations offered automatically online, as well as through an advisor on plan investment options, can help many participants overcome one of the most common reasons for not saving at all: hesitancy with making the right decisions on their own. This may be the primary reason for offering investment advice to plan participants.

For instance, a TIAA-CREF analysis shows that approximately two-thirds (68%) of those who took advantage of TIAA-CREF's objective advice offering chose to either save more, revisit their portfolio allocation or rebalance their portfolio. Among active plan participants, approximately half (46%) increased their savings rate.[5] That one action — increasing the contribution level — can have dramatic consequences. Under the conditions we studied, over a 30-year career, it could hypothetically result in $200,000 more in savings[6] — or, $1,100 more per month for life.[7] The difference isn't that the participants who receive advice have access to more sophisticated strategies and benefit from them. Rather, the fact is that while employees often seek advice looking for investment recommendations, once they are engaged with a provider who can offer a broader assessment of their situation, they are more likely to increase their contributions in order to stay on track with their long-term goals, based on our experience.

And then there's the value of advice as individuals' situations change. A raise, an unexpected inheritance, the birth of a child, the participant's household suddenly having a second source of income (or reverting to the participant's income alone) are all events that might call for a change in some aspect of the participant's investing behavior. At least, they should lead to a discussion. Not knowing what to do, and without resources to consult, participants can succumb to inertia and do nothing.

Retirement plan administrators have gotten some significant new tools in recent years, including the blessing of the IRS to automatically enroll employees in 403(b), 401(k), and other plans; the increased availability of target-date funds, which boil the participants' retirement-investing decisions down to a single fund; and payout funds that participants can use to manage their withdrawals once they are retired, are no longer accumulating money, and are in what the industry calls the "decumulation" phase of retirement. But the value of these tools — and plan sponsors' contributions to participants' retirement readiness — increases dramatically when advice is part of the package.

Concerns about advice: why some sponsors don't offer it

Despite the benefits that financial advice delivers to both participants and plan sponsors, many employers shy away from offering it. The big concern among employers is a concern about the extent to which a financial advice offering might expose them to litigation. Regulations relating to fiduciaries are complicated — so much so that many administrators admit they do not fully understand them (and do not rush to become fiduciaries if they're not required to).

Retirement readiness: you've got to measure it to manage it

Whatever tools or tactics are used to help improve retirement readiness, it's important that plan sponsors be able to measure their effectiveness in achieving desired results. This performance measurement should apply not only to the plan, but to the plan's advisor and provider as well. Only measurement can uncover what process improvements might be needed and determine which tactics actually lead to improved retirement readiness.

Most plan providers can measure factors such as plan participation rates, balances and savings rates. But these are only activities, and do not measure the ultimate goal of the plan: retirement readiness through income replacement.

A new capability from TIAA-CREF, Plan Outcome Assessment, allows plan sponsors to directly measure the retirement readiness of individual participants. The analysis combines salary information with each participant's plan-level information — savings rate, balance and asset allocation — and applies Monte Carlo analysis in order to produce an individual "plan outcome assessment." This is, in effect, a "score" of the participant's retirement readiness. This data, in turn, is aggregated up to the group level so plan sponsors can see how retirement-ready, on average, their participants are.

The group data can also be broken down into subgroups, if the plan sponsor sees a reason to do so. Some already have. For instance, a plan sponsor at one university has gotten breakdowns of retirement readiness by employee group (including faculty, administrative staff, and various unions). That information will allow the plan administrator to take targeted steps to increase the retirement readiness of those subgroups.

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Because of the large number of plans it serves in the not-for-profit market, TIAA-CREF has created benchmarks that individual plan sponsors can use to figure out where they stand against similar institutions, and whether and where they should look to make improvements at the group level. This "network effect" and the availability of peer group data will make the benchmarks increasingly valuable as time goes on, giving plan sponsors and their advisors a powerful new source of intelligence.

The kind of measurement and benchmarking capability described here can also support the sponsor's fiduciary responsibilities. Much attention has been paid in the past few years to the costs and value of the plan. But without assessing their participants' ability to use the plan effectively to enhance retirement readiness — which is the most meaningful measure of value — fiduciaries and sponsors cannot objectively assess whether their providers' products and services are providing significant value to the plan. And that is a key aspect of fiduciary responsibility.

To some of these plan sponsors, adding an advice component may just seem like another variable in an already complicated equation. Indeed, in a 2010 survey by Deloitte, 60% of plan sponsors who did not have an advice offering cited the potential fiduciary burden as their reason for holding back.[8]

But with a reasonable amount of effort, a plan sponsor can decide to offer participant advice and manage its fiduciary responsibilities when it does so. The plan sponsor already has fiduciary responsibility for choosing plan investments; choosing and monitoring a prudent advice provider helps plan participants to take better advantage of those investment choices.

A recent survey of experts in behavioral economics, actuarial science, decision-making, and financial education and advice found that an advice offering provided clear advantages. Eighty percent of responding experts considered it "appropriate" to offer personalized advice in a defined contribution (DC) plan regarding contribution levels, asset allocations and decumulation strategies. And two-thirds considered it "extremely appropriate" to offer advice for these three decision areas. Furthermore, most respondents felt that it is necessary for the typical participant to receive personalized advice in order to experience good outcomes in a DC plan.[9]

What is a fiduciary?

ERISA defines several types of plan fiduciaries. Here are brief definitions of some of them.

Named Fiduciary: Internal or external individual responsible for "running" the plan — including controlling, managing and administering the plan.

Plan Administrator: Files all the forms, discloses all the information, hires plan providers if necessary.

Trustee: Individual or group with exclusive authority and discretion over the management and control of plan assets. The Named Fiduciary often serves as a trustee too since they have responsibility for the overall plan — not just the assets.

3(38)Investment Manager: A fiduciary with full discretionary powers for selecting, monitoring and (if necessary) replacing the investment options. Could outrank the Trustee if appointed by the Named Fiduciary.

Investment Advisor: No explicit discretionary authority over the operation of a plan, but may exercise effective discretion through its influence upon others.

Elements of a sound advice offering

Experts in personal finance say a financial advice offering within a retirement plan should have a half dozen or so key characteristics. First, it should be delivered by a fiduciary. It should focus on participants' retirement readiness. The advice that's provided should be actionable — a participant should have no doubt about what the recommendation is. The advice should be unbiased — derived from forward-looking assumptions based on historical market returns, as well as a forward-looking outlook. Moreover, the advice should be augmented by a broader offer of related guidance and should be personalized — a goal that's much easier to achieve if the advisor has a full picture of the participant's overall financial status, including any retirement assets in plans or IRAs elsewhere. Finally, the advice should recognize the importance of lifetime income, laying out an array of options, including but not limited to annuities, to increase the likelihood of participants having a stream of cash that will last their whole lives.

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In addition, a well-constructed advice and guidance offering should be available in a variety of formats and delivery methods. Online discussions, video chats and podcasts are just a few of the innovations that can make delivery simpler and more cost-effective for participants and plan sponsors. The simplicity and accessibility that technology offers can also help minimize fear and anxiety participants may have about retirement planning and help foster the financial literacy and understanding that is key to long-term retirement security. Most sponsors will find that a blended approach — one that incorporates technology, education curriculums and local, on-site planning professionals — can make a dramatic difference in engagement and action that leads to better retirement outcomes.

What to consider when choosing an advisor

TIAA-CREF offers complimentary consultations with advice and guidance on plan assets as well as on more complex financial planning topics beyond the plan — such as portfolio management, estate and tax planning considerations, insurance and more. For individuals with these more complex needs, TIAA-CREF provides access to dedicated one-on-one relationships with experienced advisors who can help with short and long-term planning.

However, there are times when plan sponsors may choose to consider a third-party advisor in order to accommodate the needs of their participants. In these instances, plan sponsors should develop a vetting process, tailored to their own priorities, that helps assure an appropriate match for their needs. For instance, a plan with a relatively young workforce might favor an advisor that provides a particularly robust online component, since surveys have shown that younger workers often want to get financial advice online. A plan with a large contingent of Hispanic participants might gravitate to an organization that has bilingual advisors and written materials in Spanish as well as English.

Whatever the specific priorities, every plan, at a minimum, must look for a person or group of people who have demonstrated competencies and expertise in areas like retirement planning and portfolio management strategy and show a clear understanding of what it means to be a fiduciary. A variety of certifications, such as the Series 7, Certified Financial Planner (CFP), and Chartered Financial Consultant (ChFC), among other, broader licenses, offer evidence of qualifications in these areas.

For outside Registered Investment Advisors (RIAs), the TIAA-CREF Advisor Network helps identify RIAs by geographic area and requires a thorough vetting of each advisor on the list. Call our Advisor Services hotline at 888 842 0318 to learn more about our Advisor Network.

How could advice work for you?

Would adding an advice component to your plan make sense? If your plan already has an advice component, are participants getting what they should out of it? Here are some basic questions to help you think about the value of an advice offering.

For plan sponsors thinking of offering advice:

- Do you know how retirement-ready your participants are, on average?
- Do you know how satisfied employees are with your retirement plan?
- Are there specific behaviors on the part of your participants that are jeopardizing their prospects for a secure financial retirement?
- Do you have a clear sense of how an advice offering might lead to better behaviors?
- Do you know how an advice offering would affect your fiduciary role?
- Have you created a short list of possible advisors?

For plan sponsors already offering advice:

- What percentage of your participants use your advice offering?
- Are you satisfied with the level of participant awareness about your advice offering?
- Have you and your advisor identified key metrics, such as new enrollments, increases in average savings rates, and frequency of rebalancing? Have you started to provide a “score” for participants’ retirement readiness?
- Have you analyzed whether participants who use the advice offering are more apt to meet their retirement-savings goals?
- Do you have a picture of how your plan compares to plans offered by your competitors?
- Are you satisfied with the online part of the advice offering? Has the advisor you work with shared its plans for deepening and extending what it does online?

[1] *National Consumer Survey on Financial Advice and Education,* KRC Research, August 2012.

[2] *Financial Counseling, Financial Literacy, and Household Decision Making,* Pension Research Council, October 2010.

[3] Fact sheet, U.S. Department of Labor, Employee Benefits Security Administration, March 30, 2011.

[4] To avoid the application of the prohibited transaction provisions of ERISA, the advice is often provided by an independent source apart from the vendor that provides funds for the plan, because an advice fiduciary cannot use its authority to increase its own compensation.

[5] Based on survey of all participants that received TIAA-CREF's pension advice in 2011 across all channels (FCG, Wealth and AIS) and delivery methods (phone and in-person). N=146,848.

[6] Based on TIAA-CREF proprietary research, 2010-2012. In 2010, the average annual contribution of premium paying participants who took advantage of our Advice offering was $11,900 prior to the session and $13,700 after the session, representing an increase of 15%. Hypothetically, over a 30-year period, the additional accumulation at retirement will be $204,388. This assumes end-of-month contributions, 6% annual rate of return and 3% annual premium increase rate.

[7] The payout annuity in all cases assumes a 65-year-old retiree, single life annuity with 10 years guaranteed, 4% rate of return, and the mortality assumptions used in computing current total income under TIAA pension payout annuities. The experience of each investor depends on a number of factors and individual experience will vary. These calculations are purely hypothetical and do not illustrate past or projected performance. Past performance is not indicative of future returns. Account balances depend on employee and employer contribution rates as well as performance of the investments selected. Payout rates may vary.

[8] Annual 401(k) Survey Retirement Readiness, 2010 Edition: http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_consulting_2010annual401kbenchmarkingsurvey_121510.pdf

[9] *Rethinking defined contribution retirement plan design: a survey of experts,* Paul J. Yakoboski, TIAA-CREF Institute, August, 2011.

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