Retirement Readiness in the 21st Century: A Powerful New Focus for DC Plan Management

A recent study of full- and part-time employees in the United States reveals a welcome statistic for benefits plan managers: 81% of workers trust the financial information provided by their employers. That makes employers one of the most trusted sources of information, ahead of both financial institutions and workers' own families. In contemplating this responsibility, it is helpful for organizations to examine their retirement plan in light of four drivers: plan design, investment solutions, employee engagement and plan management. This article explores how each of these drivers—supported by some of the latest findings from TIAA-CREF research—can have a significant impact on plan outcomes and retirement readiness.

by **Edward Moslander** | *TIAA-CREF*

Retirement plan sponsors today carry a heightened responsibility. They continue to be stewards of the institution's retirement plans and the assets that are critical to their employees' future. Yet they have fewer resources of their own to do so and are in a tough regulatory environment and under harsh economic conditions. From our experience, the most effective steps institutions can take to ensure that employees will be ready for retirement are:

- Encourage enrollment and adequate contribution levels.
- Include in-plan investments that provide lifetime income options.
- Provide advice, beyond guidance, that helps drive action and outcomes.
- Offer accessible, streamlined participant communication and education tailored to an individual's unique situation and goals for financial well-being.
- Monitor progress toward retirement readiness and set benchmarks for success.

A recent study of full- and part-time employees in the United States reveals a welcome statistic for benefits plan managers: 81% of workers trust the financial information provided by their employers.[1] That makes employers one of the most trusted sources of information, ahead of both financial institutions and workers' own families.

In addition to stewarding their institution's retirement plan and the assets that accumulate, employers must pay attention to ensuring that employees will be financially ready for retirement. With today's new model of plan management, protecting the assets in a defined contribution (DC) retirement plan is only part of the equation. Equal attention should be focused on the factors that can contribute to employees' best possible retirement outcomes. This means focusing on important issues like plan design, investment choices, advice offerings, fees and much more.

That can be difficult to do in an environment marked by changes in regulations, communications and technology. But a renewed focus on the goal of achieving retirement readiness for employees can help employers clarify the many decisions they make about structuring and managing their plans, choosing its investments and partnering with providers to help meet the lifelong needs of employees. In this article, we will explore four key drivers—supported by some of the latest findings from TIAA-CREF research—that can have a significant impact on plan outcomes and retirement readiness:

1. **Plan design** that encourages employee savings
2. **Investment solutions** that provide employees with lifetime income options
3. **Employee engagement** with a focus on outcomes-based education and advice
4. **Plan management** that helps mitigate fiduciary risk, drive efficiency and maximize value.

Plan Design That Encourages Employee Saving

Best-in-class plan design can help employees save enough to meet their income needs in retirement. Plan sponsors can boost the possibility of success by making it easier for employees to enroll and keep their money in the plan, increase their contributions, allocate their investments and generate a stream of lifetime income.

It's not unusual, for instance, for employees to delay plan enrollment. Based on TIAA-CREF's 2014 *Investing in You Survey,* more than one-third (37%) of employees who were not automatically enrolled in their plan waited six months or longer to do so. Once enrolled, too many employees never increase their contribution rates. As Figure 1 shows, 26% of employees have not increased contributions in over a year, and another 36% have never increased their contribution rate.[2]

These statistics highlight the importance of including plan design features that increase the odds of achieving better outcomes. Those features include:

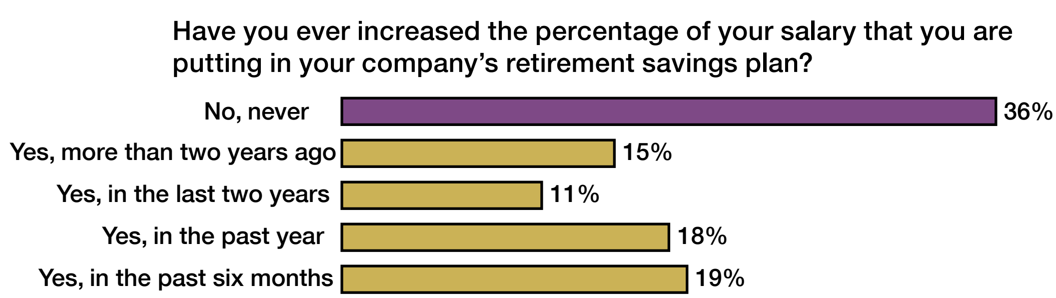
An Employer Match Formula That Enhances Participation and Maximizes Contributions

An employer match is the single most significant factor in determining whether employees contribute to a DC plan, nearly tripling the odds of participating.[3] According to TIAA-CREF's *Perfect Match Survey,* 78% of Americans who contribute to an employer-sponsored retirement plan get matching contributions from their employers. However, 23% of those employees are still forgoing some or all of their matching funds.[4]

To encourage employees to contribute as much as they can, a clear and simple formula—one that encourages

FIGURE 1

One-Third of Americans Have Never Increased Their Retirement Plan Contribution Rate

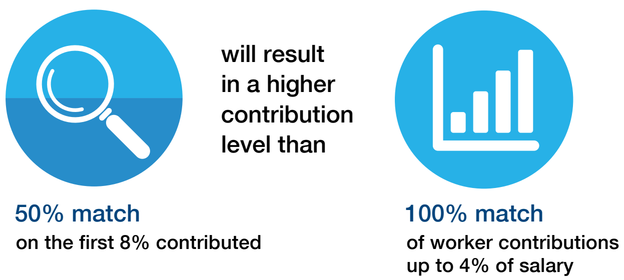


Source: TIAA-CREF 2014 *Investing in You Survey.*

FIGURE 2

Matching Formulas Have an Impact on Contributions

Source: TIAA-CREF, "Prepared for a lifetime: Managing your plan to drive retirement readiness," January 2014.



saving a larger percentage of salary—is necessary. For example, instead of matching 100% of worker contributions up to 4% of salary, matching 50% on the first 8% contributed will result in a higher level of employee contributions (Figure 2). Too low a match—under 50%—may not be seen as attractive or inspire enrollment.

Increasing communications about employer contributions is also critical. The *Perfect Match Survey* found that the majority (72%) of employees who are not saving enough to get the match want to hear from their employers about matching contributions (Figure 3).

Employees also need to better understand the value of the match over time, even if the percentage seems small. For example, when asked about a hypothetical scenario in which an employer match would have been worth $72,000,[5] one-third of respondents underestimated its value at less than $50,000. Offering employees concrete examples like this one can help them understand the importance of meeting their match.[6]

Guardrails to Help Protect Retirement Assets From Early Depletion

Employees are taking sizable loans that can seriously reduce their retirement savings—and they are not doing so just once for an emergency.

The TIAA-CREF *Borrowing Against Your Future Survey* found that more than 40% of Americans with an employer-sponsored retirement plan have taken two or more loans, and nearly half (47%) borrowed more than 20% of their retirement plan savings.[7] These loans can significantly reduce the long-term value of a retirement account due to lost earnings. For instance, a $10,000 loan paid back over five years could mean employees are forgoing more than $3,500 in potential earnings.[8]

Taking a loan also can affect an employee's savings behavior. In the survey, 57% of respondents said they slowed down their contributions while they paid back their loans, 21% reduced their contributions by at least 50% and 5% stopped contributing altogether. Overall, of the 29% of participants who said they took a loan from their retirement plan, almost half of them regretted doing so.

To discourage employees from raiding their retirement plans as a source of funds for big-ticket items or unexpected expenses during the accumulation years, strongly consider placing limits on the number of loans employees can take against their retirement assets. In addition to improving employees' retirement readiness, limiting loans can also help keep plan expenses down and have a positive impact on overall plan fees.

Income Replacement Goals and Annuitization to Fill Any Income Gaps

For employees' retirement savings efforts to be truly effective, it's important they set a target income replacement rate—typically in the range of 70% to 90% of preretirement income—comprising all income sources, including Social Security.

But even when keeping that target in sight, many employees still find that they have a retirement income gap when it comes to covering essential expenses in retirement—a shortfall between what they expect from guaranteed sources such as Social Security and any pension payments and what they need to cover their basic, nondiscretionary living costs once they retire. A fixed income annuity—purchased during the employee's savings years or at retirement—can provide a guaranteed source of retirement income to help close this gap.

Investment Solutions That Provide Employees With Lifetime Income Options

As noted above, a plan's investment menu should offer employees opportunities to both accumulate assets and create lifetime income. TIAA-CREF's *Lifetime Income Survey* found that more than one-third (34%) of Americans who participate in a retirement plan said the primary goal for their retirement savings plan was guaranteed income every month to cover living costs. Another 40% wanted to ensure their savings were safe regardless of what happens in the market.[9]

In addition, 44% of those respondents said they were somewhat concerned (20%) or very concerned (24%) that they could run out of money in retirement. But just 21% expected to receive income from lifetime annuities.

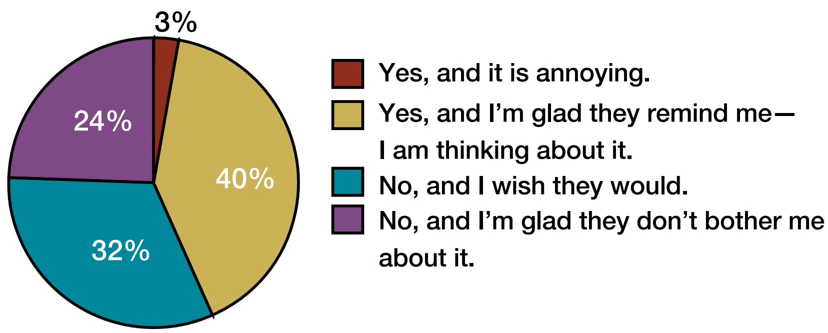
Helping employees invest wisely so they can meet their basic financial obligations throughout retirement is critical to employee confidence and success in retirement. Some ways to accomplish this include:

FIGURE 3

Employees Want to Hear From You About the Match

*Responses from survey participants who are not getting their full employer match.

Does your employer send reminders about matching contributions?*



Source: TIAA-CREF 2014 *Perfect Match Survey.*

Carefully Build a Menu Designed to Help Employees Get to and Through Retirement

A prudent approach to menu construction should help employees prepare for a safe and secure retirement—those who require a simple menu and others who want a variety of choices so they can build their own portfolios. A plan's menu should make it easy for employees to build retirement portfolios that address their needs for accumulation and future income.

This means that, in addition to selecting a qualified default investment alternative for employees who are automatically enrolled in the plan, plan menus should offer:

- A reasonable number of core investment choices for employees who want to build their own portfolios
- Lifetime income products to deliver income in retirement (see "Include Low-Cost, Lifetime Income Options as a Plan Investment" discussion, on the next page).

The plan menu also may include a brokerage window for even more expansive choices and alternative investments.

It's not enough just to carefully select retirement products on the menu. Employers should also provide employees with access to advice—in addition to education and guidance—to help them understand the pros and cons of available options and select investments based on their needs and risk tolerance. They must understand how much they will need in retirement and exactly how to turn their savings into income they won't outlive.

Avoid Investment Option Overload

Having too many investment choices can lead to employee inertia and indecision and require greater fiduciary rigor and administration to manage.

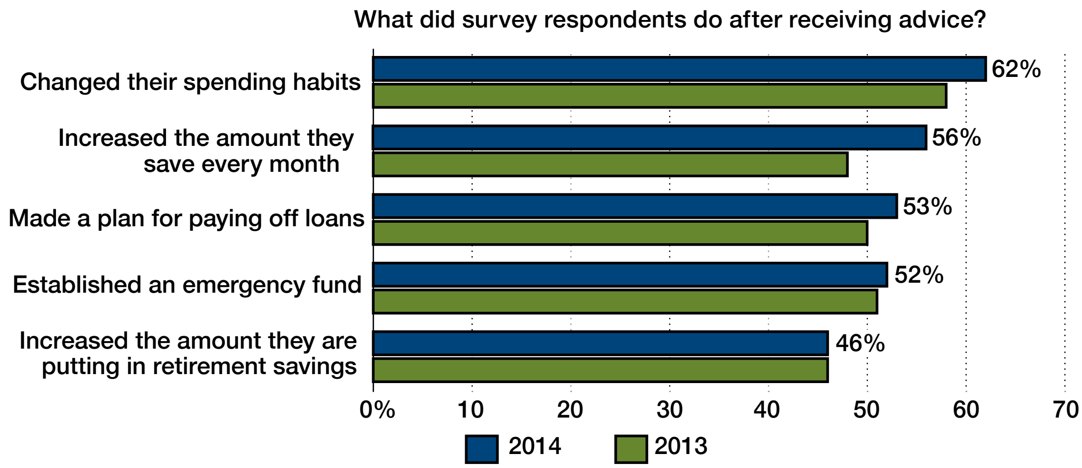
So, what is the right number of menu options? A TIAA-CREF Institute survey of experts in behavioral economics, actuarial science, decision making and financial education found that offering between five and ten investment choices—with target-date funds counting as one option—was most effective.[10] This was the range that could deliver an appropriately diversified portfolio for the typical employee without making it too difficult to make investment decisions.

Include Low-Cost, Lifetime Income Options as a Plan Investment

Industry research shows that guaranteed income resonates with employees. One study found that 72% of employees were interested in contributing to an investment option within

FIGURE 4

Advice Leads to Action



Source: TIAA-CREF 2014 *Advice Matters Survey.*

their plan that focused mainly on generating a guaranteed monthly income in retirement.[11] Yet TIAA-CREF's *Lifetime Income Survey*—based on a random sample of the general population—found that a similar percentage (72%) of respondents either did not have or were unclear whether their retirement plan offered such a lifetime income option.[12]

Employers can help meet employees' needs by providing in-plan lifetime income investment options, like low-cost annuities, and educating employees about how these offerings work. At TIAA-CREF, most retirement plans sponsored by not-for-profits or government entities follow this approach and offer in-plan annuities that can contribute to higher income replacement ratios.[13] Some employers can take an even more active approach and direct a portion of their contribution to participants' accounts into in-plan annuities. In terms of retirement readiness, employees who contribute to a lifetime income product through their workplace plan are better prepared and more likely to face a smooth transition to retirement. Investing in an annuity during accumulation also removes the psychological barriers to purchasing an annuity with a single large sum after retirement. In fact, TIAA-CREF Institute research found that individuals were more than twice as likely to annuitize in retirement if they saved through an annuity in a DC plan during their working years.[14]

Employee Engagement With a Focus on Outcomes-Based Education and Advice

A well-thought-out DC plan design and a carefully crafted investment menu are essential to driving better outcomes, but employees are unlikely to benefit from a plan if they are not taking an active role in their own retirement planning. So how do employers capture the attention of employees who have so many other priorities to worry about?

Our experience with plan sponsors suggests that engaging employees in improving their retirement readiness requires a deliberate focus on three fundamental building blocks: segmentation, advice and guidance, and technology and multichannel communications. Reaching specific groups of employees with the right message according to their preferences (in-person seminars, one-on-one advice, reading materials, online education, interactive tools, mobile apps and gaming) can increase participation, savings rates and retirement readiness.

Segment Employees to Create Relevant Messaging

To be effective, employers may want to segment employees—based on generations, gender or other criteria—to better understand the different hurdles they face and create different messages that will resonate with each group. And the more specifically messages target each distinct audience in the workplace, the more successful these efforts are likely to be.

For example, for younger employees for whom retirement is many years away, employers may need to pave the way to plan enrollment by focusing messages on their immediate concerns about debt and budgeting and reaching them via social media and mobile channels. Likewise, women often face unique challenges as they try to save for retirement because of longevity and work patterns. Crafting a customized educational campaign can help them meet these challenges successfully.

The number and type of employee groups employers focus on will depend on plan goals, employee demographics and company resources. That's when a strong relationship with a DC plan advisor and provider can help employers understand and address multiple segments to better engage the workforce.

Offer Real Advice as Well as Guidance

As noted earlier, the vast majority of Americans surveyed (81%) by TIAA-CREF said they trust financial information from their employers—a greater number than those who trust their banks or retirement plan providers (69%) or their own families (63%).[15] That puts employers in an enviable position to offer advice and guidance that can help improve employees' retirement readiness.

General guidance might take the form of workshops, printed or online materials, online tools and calculators and one-on-one consultations with financial experts. This type of guidance may be enough for some employees, but many will want or need more individualized assistance in making retirement planning and investing decisions.

Personalized advice—including specific recommendations about how to invest money as well as educational information about investing topics—is a powerful tool to help engage employees with their retirement planning and improve their financial well-being. This type of assistance may be the answer for those employees looking for specific fund recommendations tailored to their individual circumstances.

To be effective, advice must be affordable, personalized, easy to understand and holistic, taking into account investments outside of the plan. It must be tailored to variables such as age, current savings rates, investment preferences and tolerance for risk. It must also enable employees to take action that may help improve their retirement readiness. In fact, 86% of Americans taking part in TIAA-CREF's *Advice Matters Survey* said they positioned themselves for better retirement outcomes as a result of the advice they received.[16] Figure 4 shows some of the actions these investors took.

Use Technology, Interactive Tools and Multichannel Communications to Reach Them

Using new technologies is no longer an option; it's an imperative. Sixty percent of U.S. consumers now have smartphones and 33% have tablets to help them manage their lives—trading text messages, keeping in touch with kids after school, paying bills online, checking weather or placing reminders about medications or flight arrivals.[17]

Retirement planning is no exception to this trend: Mobile traffic at TIAA-CREF doubled in 2013, with three million visits (19% of the total) to our site coming from tablets and smartphones.[18] While abandoning paper communications altogether is unlikely in the short run—plenty of employees still want or need them—engagement strategies that include consumer-centered digital applications are much more common today.

And the good news is that technology and new mobile applications can increase participation and boost savings behavior. Our analysis found that 54% of employees who used an online advice service reported saving more, changing their future allocations or rebalancing their portfolios.[19]

Some technology-driven enhancements to consider for a DC plan are as follows:

- Allow enrollment on the spot through handheld devices, such as iPads, to get employees started online and capture data that can be used to target education, communications and better service.
- Offer interactive tools to help employees chart, evaluate and experiment with various scenarios to help them set their retirement goals, see if they are on track and design distribution strategies to generate income they won't outlive.
- Include income projections in

quarterly statements to help employees track their progress and keep their retirement readiness and future income top of mind.
- Incorporate online gaming into the engagement strategy. Gaming capabilities can help educate employees in fun and simple ways that highlight and engage them with existing benefits programs. This approach can work with all employees but can be especially effective with younger employees who are avid technology and gaming users outside of the workplace.

Plan Management That Helps Mitigate Fiduciary Risk, Drive Efficiency and Maximize Value

Even the best-designed DC plan will be inadequate if it doesn't have the benefit of strong plan management. And the right management practices will help employers meet their fiduciary and compliance obligations as well as streamline plan administration. More efficient operations benefit everyone—providing faster and more accurate day-to-day transactions, helping to contain or reduce administrative costs and enhancing financial and regulatory reporting.

Mitigate Fiduciary Risk With Processes for Plan Governance and Oversight

Employers should take advantage of the training and materials offered by the Department of Labor, providers and benefits consultants so that, as plan fiduciaries, they are aware and up to date and can efficiently meet these obligations.

Review and Streamline Plan Operations to Drive Efficiency

More efficient operations can result in an improved experience for employees and easier administration for employers. Moving to more electronic interactions at various points in the administrative process improves speed, efficiency and accuracy.

Evaluate the Service Model

Ever since regulatory and legislative mandates changed the way employers operate and manage their 403(b) plans, many retirement plans sponsored by not-for-profits and government entities have adopted a single-recordkeeper approach.

Sole recordkeeping offers many advantages. It delivers a streamlined and simplified experience, provides one point of contact for the plan, offers a single investment platform, provides a more holistic picture of employees and also facilitates fiduciary oversight, reporting and compliance activities. In short, sole recordkeeping can be a powerful force to drive improved plan efficiency and positive, more measurable participant outcomes.

Get Maximum Value for Fees

Current fee disclosure and transparency requirements come with increased responsibility for employers. This responsibility includes defining and maximizing value for the services provided to the plan. And the reality is that the assessment is about more than minimizing fees. A focus solely on efficiency or the lowest possible cost may sacrifice important employee outcomes and even overlook sources of value for the plan. Employers should weigh the value against the fees assessed to the plan and to the employee to determine whether plan fees are reasonable.

Getting Employees to a Safe Retirement

It's natural for employees to look to their employers for help navigating today's new retirement landscape. Amid the noise and confusion in the marketplace, employers can be a genuine source of confidence in supporting employees' lifelong retirement security and make a real difference in their ability to get to and through retirement.

Doing this well requires a retirement plan with both asset accumulation and lifetime income planning as twin imperatives that are critical to retirement readiness and successful outcomes. It also means taking a long-term, all-inclusive view of a DC plan from design features that encourage enrollment and savings; to investment choices that include income options; to engagement strategies that address each employee's unique needs in today's rapidly changing multichannel world; and to plan management practices that drive efficiency.

While employees eventually will retire, their plan assets increasingly will be the most important source of income they have for the 20, 25 or 30 years they spend in retirement. Directly or indirectly, retired employees will continue to count on employers for retirement income and security. Understanding the latest research and plan design and implementation options is critical to helping them achieve their goals. BQ

Endnotes

1. The findings come from TIAA-CREF's first *Investment Options Survey,* conducted by an independent research firm January 3-5, 2014. Polling was among a national random sample of 1,017 adults aged 18 and over. The margin of error for the entire sample is plus or minus 3.1 percentage points.

2. The TIAA-CREF *Invest in You Survey* was conducted online by KRC Research, a third-party research firm, May 19-28, 2014 among a national random sample of 1,000 adults aged 18 and over currently contributing to an employer-sponsored retirement plan. Data was weighted by key demographic variables to ensure that the sample reflects the national population distribution.

3. *The Plan Participation Puzzle: Comparison of Not-for-Profit Employees and For-Profit Employees,* LIMRA, December 2010.

4. The TIAA-CREF *Perfect Match Survey* was conducted online by KRC Research, a third-party research firm, among a national random sample of 1,000 adults contributing to an employer-sponsored retirement plan. Data was weighted by key demographic variables to ensure that the sample reflects the national population distribution.

5. Survey respondents were asked how much they would earn from their employer match alone if they started contributing at the age of 35, earned $50,000 annually for 30 years, had a 3% match, contributed enough to reach the full match and their investments earned 3% per year. In this scenario, the employer match would be worth $72,518. This is purely hypothetical and is not intended to predict or project returns.

6. The TIAA-CREF *Perfect Match Survey* was conducted online by KRC Research, a third-party research firm, May 19-28, 2014 among a national random sample of 1,000 adults aged 18 and over currently contributing to an employer-sponsored retirement plan. Data was weighted by key demographic variables to ensure that the sample reflects the national population distribution. Available at www.tiaa-cref.org/public/about/press/about_us/releases/articles/pressrelease511.html.

7. The TIAA-CREF *Borrowing Against Your Future Survey* was conducted online by KRC Research, a third-party research firm, among a national random sample of 1,000 adults contributing to a 401(k), 403(b) or defined benefit plan. Data was weighted by key demographic variables to ensure that the sample reflects the national population distribution.

8. This scenario assumes the borrower is 40 years old, with 25 years left until retirement; that it is a five-year loan, with 6% loan interest; and that there would have been an 8% return on funds over the next 25 years if the loan had not been taken. This is a hypothetical illustration. These returns are for illustrative purposes only and do not reflect actual performance or the fluctuations inherent in investing.

9. The findings come from TIAA-CREF's first *Lifetime Income Survey,* conducted by an independent research firm January 3-5, 2014. Polling was among a national random sample of 1,017 adults aged 18 and over.

10. Paul J. Yakoboski, TIAA-CREF Institute, *Rethinking Defined Contribution Plan Design: A Survey of Experts*, August 2011.

11. Retirement Research Inc./Brightwork Partners, 2011.

12. TIAA-CREF *Lifetime Income Survey,* 2014.

13. Benjamin Goodman and Michael Heller, "Annuities: Now, Later, Never?," *Trends and Issues,* TIAA-CREF Institute, October 2006.

14.Paul J. Yakoboski, *Retirees, Annuitization and Defined Contribution Plans,* TIAA-CREF Institute, April 2010.

15. TIAA-CREF *Investment Options Survey,* 2014.

16. TIAA-CREF *Advice Matters Survey* Executive Summary, September 9, 2014. Available at www.tiaa-cref.org/public/pdf/C19112SeptemberAdviceSurveyExecutiveSummary.pdf. TIAA-CREF's 2014 *Advice Matters Survey* was conducted by KRC Research, a third-party research firm, by phone among a national random sample of 1,000 adults aged 18 and over in August 2014. The survey was not conducted among TIAA-CREF participants, and the survey questions and responses did not reference or concern any TIAA-CREF product, service or client experience. Interviews were conducted over a landline and cell phone sample.

17. Forrester Research, *The State of Consumers and Technology: Benchmark 2013,* January 2014.

18. *Retirement Readiness Starts with Employee Engagement* report. TIAA CREF, July 2014.

19. Based on 2013 TIAA-CREF proprietary research of 17,741 TIAA-CREF participants who used TIAA-CREF Retirement Advisor (online advice) from February 2012 through January 2013 and took action within the same time period.

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