

A blueprint for retirement success

Five strategies for mitigating fiduciary
risk and enhancing employee readiness
through workplace savings plans

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Introduction

The purpose of an employer-sponsored defined contribution plan is to help employees build up the money they will need to live on in retirement. This Paper discusses why employers should want to structure their plans to achieve that goal and to provide five strategies for success – for both the employer and its employees. While the discussion focuses on tools for retirement savings accumulation, this is only the means; the end is to help employees have a secure retirement¹, after they stop receiving a paycheck.

Having a secure retirement – or achieving retirement readiness – is a growing concern for both employers who sponsor a retirement plan, and the employees who participate in one.² Helping employees achieve a secure retirement—and at the same time benefiting the business and reducing the employer’s fiduciary risk – is less difficult than it may seem. Legislative and regulatory changes in the last decade have made it possible for employers to adopt solutions that are easy to implement, cost-effective and less risky than employers may believe. In the following pages, we discuss five of these solutions:

1. Automatic enrollment
2. Successful default options
3. Effective employer match
4. Automatic escalation of deferrals
5. Re-enrollment

¹ In this paper, “success” and “secure retirement” refer to having sufficient retirement savings that, when combined with personal assets and Social Security, will enable a retiree to live comfortably in retirement. This is also sometimes referred to as “retirement readiness.”

² See PwC LLP 2016 Employee Financial Wellness Survey.

While these are not new concepts, we focus on them here because these plan design solutions help address such an important issue.

Each of these design features, operating independently, can be effective in helping employees. But when all five are combined into the Blueprint for Retirement Success, the result is powerful. This Paper will explain how each of these solutions works, address common myths that may hold employers back from implementing them, and highlight the importance of taking action now to create successful plan and participant outcomes.

We refer to these strategies as a blueprint for a specific reason: to build a house you need an overall design along with the specific details of each element for a secure structure. You could decide to use only parts of the blueprint – lay the foundation, put up walls, add a roof and stop there. But the house would be incomplete.

The same is true for the concepts discussed in this paper. You can pick and choose among the strategies, or you can use the entire blueprint to help ensure that employees are in the plan, are properly encouraged to defer more on their own, are deferring more each year even when they don't elect it themselves, and are properly invested. Even though we discuss each element separately, we believe that using them as an integrated package results in a better "retirement house."

Why employers should care

Earlier we said that employers should want to help their employees to a secure retirement. We are sometimes asked why employers should care about this, since there is no legal obligation under ERISA to provide any specific level of benefits.³ We offer three reasons:

- 1 For some employers, the answer is simple: they think it's the right thing to do.
- 2 For others, the answer may be equally simple: it provides benefits to the employer in terms of employee engagement, productivity and loyalty.
- 3 For all, it can help mitigate the fiduciary risk associated with sponsoring a plan.

A recent survey pointed out that "it is important for employers to show that they care about employee financial well-being as this will likely impact retention, recruitment and productivity of the workforce...."⁴

The strategies discussed in this paper can help employers in a variety of ways. It may help attract and retain younger workers who see that the employer cares about its employees. It can minimize the amount of time employees concerns about their personal financial security.⁵ For those employees nearing the end of their careers, it can make them to feel more confident that they can afford to retire. And by supporting older workers when they are no longer as committed, it may help retain a dedicated and productive workforce and reduce costs.⁶

³ ERISA refers to the Employee Retirement Income Security Act of 1974, as amended, which governs workplace retirement plans.

⁴ PwC LLP 2016 Employee Financial Wellness Survey.

⁵ Voya Retirement Research Institute, *Redefining Retirement Readiness* (2015), at page 7. 83% of workers say they spend at least some time every week, at work, thinking about personal finances.

⁶ Id., at page 10.

Perhaps the most compelling reason for employers to use the Blueprint strategies is that they can provide greater fiduciary protection, including ERISA fiduciary safe harbors. Even without the specific safe harbors, however, they help plan sponsors fulfill the exclusive purpose requirement and the duty of loyalty under ERISA.⁷ They can also reduce employee complaints and potential litigation by having participant accounts invested in prudent portfolios that accumulate more savings, with the goal of generating a reliable income stream at retirement.

Concerns employers may have about these solutions that might impede adoption include: cost, complexity, employee morale issues and fiduciary risk. But perhaps the biggest hurdle is overcoming inertia, both an employer's and the employees'. Once employers understand how straightforward it can be to implement these solutions it is the easier it is for them to take action. But reassuring employers is only half the battle, because employees face their own sources of inertia: change can be hard; people are busy; employees have competing priorities for their time and resources; financial decisions, especially about retirement, seem too complicated. Properly explained, these can also be overcome using the solutions discussed in this paper.

Four of the five concepts we discuss are easy to implement because they do not require any action from employees. When solutions are easy to adopt – with little, if any, employee involvement – the foundation is laid for successful outcomes for both the employer and the employee. Here's what we mean:

- **Plan participation and deferral percentage:** Two of the biggest roadblocks to a secure retirement are the failure of employees to participate in and defer

an adequate amount of their paycheck into their savings plan. These can be overcome through automatic enrollment, which gets employees into the plan, and then through an automatic deferral escalation feature, which gets them deferring at increasing rates over time. Both of these are designed as default features – that is, employees are automatically enrolled in the plan and their deferrals increase automatically unless they expressly opt out.

- **Investment Selection:** Another major impediment to participants achieving a secure retirement is their selection of appropriate investments. This, too, can be largely overcome through two automatic solutions – the selection of “successful” qualified default investment alternatives (QDIAs), by which we mean those that provide a meaningful return without inappropriate exposure to market volatility, and re-enrollment, which also makes use of QDIAs.
- **Employer match:** Structuring the employer match as an incentive to encourage more employee deferrals also helps produce better employee outcomes. This solution does require affirmative participant action.
- **Re-enrollment:** Under this strategy, employees are required to re-select their deferral rate and their investment options. If they fail to do so (and do not opt out), they are re-enrolled at a new, generally higher deferral rate and are defaulted into the plan's QDIA. Since a meaningful percentage of participants fail to take action, the result is that, in many cases, the participant accounts wind up with greater deferrals and better invested; and the employer obtains a fiduciary safe harbor.

⁷ ERISA Section 404(a) requires fiduciaries to act for the exclusive purpose of providing benefits and in the interest of the employees. The latter is often referred to as the “duty of loyalty.”

A blueprint for retirement success

As part of the blueprint, we address the obstacles that may impede adoption of the strategies we discuss as well as the reality showing that the concerns are not realistic. Finally, we point out what employers can and should be doing now to overcome inertia, promote employee readiness and obtain fiduciary protection. Employers will find support for the Blueprint in existing laws and regulations.

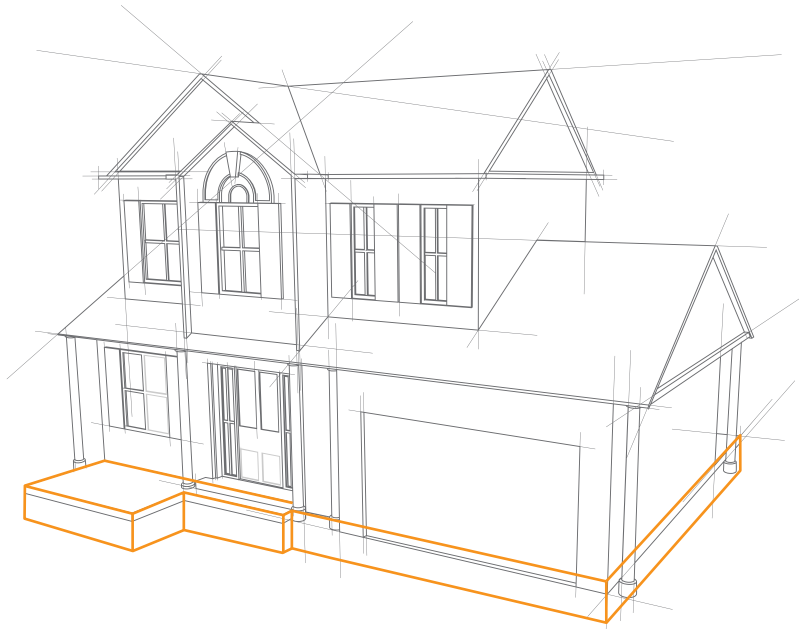
For example, the 1996 Pension Protection Act added automatic enrollment to ERISA, along with the fiduciary safe harbor for defaulting participants.⁸ Re-enrollment received implicit approval in the DOL regulation defining a qualified default investment alternative (QDIA) and the circumstances in which the safe harbor was available.⁹ Automatic escalation of deferrals arrived with changes in the Internal Revenue Code provisions for savings testing.¹⁰ Matching contributions have been around for decades, though innovations in their use to promote retirement savings have evolved more recently.

Recent survey findings lead to two related conclusions: employees need help in achieving a secure retirement, and providing that help also benefits the employer.

⁸ ERISA Section 404(c)(5) and Regulation Section 2550.404c-5.

⁹ See footnotes 50 and 55 in Appendix A.

¹⁰ Code section 401(k)(12)



1

Laying the foundation: Automatic enrollment

THE PERCEPTION

Implementing automatic enrollment is too hard. We'll have to devote too much time and effort to getting it done, and the employees won't appreciate it anyway.

THE REALITY

A simple plan amendment and appropriate notice is all it takes.

It takes only a simple plan amendment and appropriate notice to employees to implement automatic enrollment. The process is handled by the plan provider – but make sure you are working with a competent, experienced firm. And the process is successful...surveys suggest that employees may appreciate having this taken care of for them, because the opt-out rate is relatively small.¹⁸ Plus, plans with an automatic enrollment feature have participation rates about 10 percentage points higher than plans that don't (86.6% vs. 73.7%).¹⁹

¹⁸ Fred Barstein, 401kTV, *DC Participants Overwhelming Favor Auto Features*, 7/21/2016, citing to a study showing that the opt out rate is 1%.

¹⁹ PSCA SURVEY – PAGE 66)

It may seem self-evident, but in general, the only way employees can accumulate retirement savings in an employer-sponsored plan is if they participate...that is, if they have deferrals going into the plan.²⁰ Absent employee participation, there is no account balance and little, if any, chance for employees to accumulate savings for a secure retirement.

The basic concept of a savings plan – which is the primary savings vehicle for most working Americans today – is for employees to affirmatively elect that a portion of their pay be deferred into the plan. In essence, the “default” is that employees do not participate in the plan and do not save for retirement unless they affirmatively chose to do so.

Nearly a decade ago, ERISA was amended to make it possible to reverse this. Employers can adopt a plan requiring employees to have a portion of their pay deferred into the plan unless they affirmatively elect not to participate.²¹ In other words, where an employer adopts an automatic enrollment feature, its employees are defaulted into the plan unless they opt out. There are also a number of provisions under the Internal Revenue Code that facilitate the establishment of automatic enrollment plans.²²

Automatic enrollment addresses the first principle of savings plans, employee participation, by overcoming employee inertia.

“Approximately 30 percent of eligible workers do not participate in their employer's 401(k)-type plan. Studies suggest that automatic enrollment

plans could reduce this rate to less than 15 percent, significantly increasing retirement savings.”²³

An additional advantage not cited by the DOL is that by increasing enrollment, it may be easier for the plan to pass various non-discrimination requirements applicable to qualified 401(k) plans under the Internal Revenue Code.

Establishing an automatic enrollment plan

The process for establishing an automatic enrollment plan is straightforward. The employer must:

- 1 **Adopt the appropriate plan provisions** prior to the beginning of the plan year in which employees will be enrolled – the plan provider or third party administrator (TPA) will generally handle this;
- 2 **Provide advance and annual notices** to affected employees regarding the arrangement and the right to opt out – the plan provider will typically generate these notices on behalf of the plan sponsor; and
- 3 **Select a default investment option** for those newly-enrolled participants who fail to give investment direction (the ease of and fiduciary benefits of doing this are discussed further in the third item in this section) – the plan’s financial advisor or consultant can assist with this.

²⁰ While some employers make profit sharing contributions to a plan for eligible employees – even for those who do not defer – in our experience, this is relatively uncommon.

²¹ ERISA Section 514(e).

²² See Code section 401(k)(13).

²³ The publication is available at www.dol.gov/ebsa/publications/automaticenrollment401kplans.html#Resources. DOL publication “Automatic Enrollment 401(k) Plans for Small Businesses.”

In adopting the plan amendment, the employer has two decisions to make: which employees should be automatically enrolled – only new hires or any employee who has not previously enrolled in the plan; and what deferral rate should be used as the beginning deferral rate? Internal Revenue Code provisions eliminate the need for discrimination testing (this is referred to as a “safe harbor” plan) if the beginning rate is at least 3% of pay.²⁵ Unfortunately,

many employees may assume that a 3% deferral rate is sufficient for the long term and fail to increase their deferrals unless the plan uses automatic escalation (discussed later). Studies show that deferring at 3% will hurt long-term prospects for retirement;²⁶ and it has been shown that using a higher automatic enrollment rate does not materially increase opt-outs and is more helpful to employees over time.

Constructing the future

There are advantages to an automatic enrollment plan, and the implementation process is relatively easy. The perceived obstacle, that implementation is difficult, is not reality.

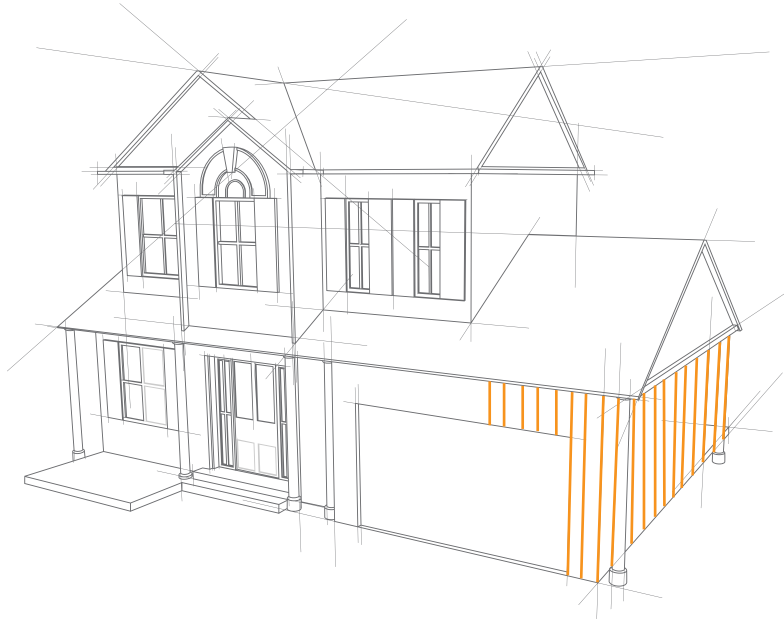
Automatic enrollment provides measurable benefits:

- The process for adopting and implementing the feature is simple.
- It benefits employers by improving plan health and employees by getting them on the path to accumulating retirement savings that translate into income at retirement.
- Rather than resenting “interference” from their employer, employees seem to appreciate being enrolled, given the small opt-out rate.
- It benefits employers by enhancing the workplace environment and possibly reducing plan costs.
- Where automatically enrolled employees fail to direct their accounts, so that their money is invested in the plan’s qualified default investment alternative (QDIA – discussed later), the plan sponsor has a fiduciary safe harbor covering the participant investing.

With no downside and a number of positive upsides, you need to ask yourself, what are you waiting for?

²⁵ Code section 401(k)(13)

²⁶ See, e.g., Sammer, Joanne, “401(k) Automatic Enrollment: Does It Help or Hurt Savings?” Society for Human Resource Management, 2011: “financial planners tend to agree that a 3 percent savings rate is not enough to secure the average person’s retirement.”



2

Building the frame: Default investments

THE PERCEPTION

We're exposed to risk for the investment of participant accounts no matter what we do. Why should we spend extra time looking for a "successful" QDIA? Let's just pick our provider's target date fund and get back to work.

THE REALITY

No short cuts here...Plan sponsors always need to follow a prudent process.

Plan sponsors are protected under ERISA if they act prudently in selecting a "qualified" default investment alternative or QDIA (this is referred to as a fiduciary safe harbor). That is, they are not responsible or liable for the investment performance of the QDIA. Nonetheless, to make sure you have selected a QDIA that will be most helpful to your employees, it's important to pick one that is suitable for the workforce, one that can produce a reasonable return for even those participants who don't have the interest or experience to make the decision for themselves.

Automatic enrollment lays a foundation to help participants begin to build their retirement savings. The next step is to build the frame by helping participants properly invest their accounts.

Plan committees are generally responsible for the investments of a savings plan.²⁷ This is true even where participants are given the authority to direct the investment of their accounts in the plan, except to the extent the plan complies with the requirements under ERISA Section 404(c) and the related regulation under that section.²⁸ But where a participant fails to direct his or her account (referred to as a “default”), the obligation falls back on the committee even if the plan is a 404(c) plan.²⁹ And this can expose the committee members to fiduciary liability if they fail to invest the account in a prudent manner.

QDIA's are now commonplace in savings plans today. ERISA provides a fiduciary safe harbor where the committee selects a QDIA into which the accounts of defaulting participants are invested.³⁰ They are free to choose one of three alternative investment types – a balanced fund, a target date fund or a managed account service – but they must still act prudently to select the specific fund, suite of funds or service provider once they have settled on the type of QDIA. After making that selection, they are not responsible for the performance of the QDIA, subject to the on-going duty to monitor the QDIA and replace it if necessary.³¹

Once the type of fund or service has been chosen, the selection of a specific QDIA requires that the plan sponsor engage in a prudent process, just like the one used for selecting any other investment or service.

The process entails collecting relevant information, evaluating the information and then making a decision that is often referred to as an informed and reasoned decision.³² In the context of selecting investments, this means looking at performance, cost, volatility, manager tenure and so on, but it also means look at the needs of the workforce, especially where a target date suite has been selected as the QDIA. And because of their structure, target date funds require the assessment of additional information about the allocation to varying asset classes and the underlying funds, as well as how both change over time.³³

For example, committees must understand the glide path of the target date funds they select. “Glide path” refers to the change in investment focus (from an equity heavy allocation to a higher fixed income allocation) as the investor approaches normal retirement age (the target date). As the target date approaches, the mix gradually changes (it “glides”), becoming more conservative, i.e., less heavily weighted to equities and more heavily weighted to fixed income). A key factor in the analysis of the suite of funds is the equity/fixed income mix at the most conservative point. Is the fund still invested in, say, 50% equities at that point or 30% and how will that change in retirement?

The glide paths used by target date funds for managing the equity and bond mix at and into retirement generally fall into two categories, “to” vs. “through”. “To” funds tend to be more conservative (i.e., have a lower equity allocation) at normal retirement age because they reach their most conservative equity allocation at retirement and maintain that equity allocation into retirement.

²⁷ ERISA Section 404(a)

²⁸ ERISA Regulation Section 404 c-1

²⁹ Id.

³⁰ ERISA Section 404(c)(5).

³¹ Id.

³² See, e.g., ERISA Regulation Section 2550.404a-1.

³³ For information about the issues the DOL considers important in selecting a suite of target date funds, see the DOL fact sheet, “Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries.”

“Through” funds tend to be more aggressive (i.e., with a higher equity allocation) at normal retirement age and continue to reduce equities in retirement. Plan sponsors should understand a target date fund’s approach near and in retirement, since target date fund managers use a vast array of investment approaches and philosophies.

Thus, a plan committee should consider whether the target date fund’s investment philosophy and approach aligns with that of the overall plan and the participants’ risk tolerances, needs and expectations. For example, suppose an employer sponsors a separate pension plan or makes significant profit sharing contributions to a plan that is professionally managed, rather than being participant controlled. In that situation, a fund with a more aggressive glide path (one that retains a higher degree of equity exposure) may be an appropriate choice, since the participants are not relying entirely on the success of their accounts to fund their retirement. But where other employer-provided benefits are not available, a more conservative approach might be better.

There are other key target date design factors to evaluate beyond understanding the glide path.

- Are the underlying funds of the target date fund diversified across various investment managers or are they all managed by a single investment firm (open vs closed-architecture)?
- Are they investing in actively managed funds or passively managed funds or a combination of the two?
- How many asset classes is the investor in the target date fund exposed to and how does that change over time?

The keys to selecting a successful default option are to thoroughly understand the terms of the funds being considered – including cost, performance, manager tenure, glide path and so on – and how the option meshes with the needs of the workforce. Even for relatively sophisticated plan committees, it is often well-advised to work with an experienced investment adviser to make the selection.

Constructing the future

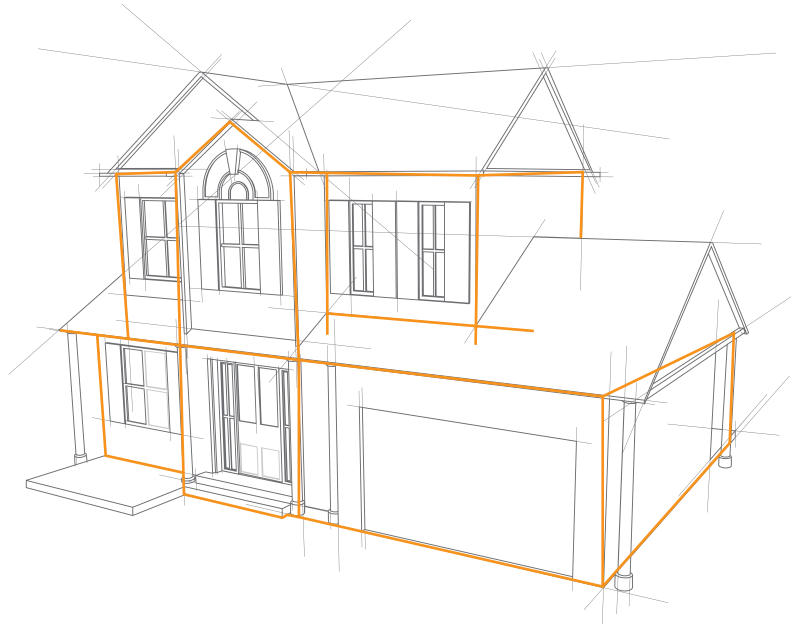
By selecting a QDIA, plan sponsors obtain the benefit of a fiduciary safe harbor. But not all QDIAs are the same, and it’s important for plan sponsors to make a prudent selection of the specific fund or suite of funds to be used as the QDIA for their plans.

They can generally receive assistance in this process by working with an experienced financial adviser and provider.

Using that process, plan sponsors can realize a number of benefits:

- Defaulting participants are benefited by being placed into a fund that should provide them with meaningful growth in their retirement savings over time.
- Better savings outcomes will benefit employers by eliminating a source of concern among the employees and reducing the risk of participant complaints.

Given the benefits of the careful, prudent selection of a “successful” QDIA, you need to ask yourself, what are you waiting for?



3

Adding the walls: An effective employer match

THE PERCEPTION

Adjusting the match just means we'll have to contribute more to the plan. We already contribute enough and can't afford to do more.

THE REALITY

This won't necessarily be more costly...consider a "stretch match."

Employees are often encouraged to defer the maximum amount needed to obtain the maximum employer matching contribution. The argument, which seems to make sense to employees, is that the matching dollars are "free"; they are like a bonus for which the employee need not expend any additional effort.

So how does an employer make its match more attractive to encourage more deferrals without spending more money? One approach is to use what some call a “stretch match.” One common match formula is 50 cents on one dollar of deferrals to a maximum of 3% of pay. But suppose the match is changed to 25 cents on the dollar to a maximum of 6% of pay. The cost to the employer is the same, but in order for an employee to obtain the maximum match, he or she must defer twice as much pay (6% versus 3%).

Most of the time, it is easy to make the change and does not require a plan amendment. The employer makes decision and announces it to the employees. Of course, there will need to be coordination with the company’s payroll service, finance department and plan provider, but these implementation steps are simple and straightforward.

Unlike automatic enrollment and default investing, a change in the match requires action by employees. They have to take an affirmative step to change their deferral rate. (The stretch match concept might be used in the context of an automatic escalation program, though the only impact would be to reallocate how an employer’s match dollars are spent. For an employer to make use of this part of the blueprint, they need to construct an effective incentive to overcome employee inertia. The good news is that this approach has generally been effective when implemented.

The reason for this is straightforward. For most employees, the match on their deferrals is a significant part of their retirement savings. Their plan provider will often encourage them to take advantage of the match

by deferring to the maximum level needed to get the full match. If the employer matches to 3% of pay, they are encouraged to defer 3% of their pay.

In this environment, the concept of a stretch match is simple. The employer announces that in order to receive the maximum match, the employee must defer a higher percentage of pay (say, 6%). Many employees will increase their deferrals to receive the maximum. Some employers will chose to retain the same rate of match, 50 cents on the dollar, for example. But others will not want to increase their costs, so they will reduce the match rate when they increase the percentage of pay to which it applies.

Studies show that employees tend to react promptly to such a change to ensure that they receive the full amount of the match.³⁴ In doing so, they increase their deferral rate and thus their overall retirement savings and the chances of achieving a secure retirement. An increase in the deferral rate of even 1% over a 20 year period can increase a participant’s account balance by nearly 10%. If the deferral rate is doubled (from, say, 3% to 6%), the impact is obviously more dramatic and more positive.

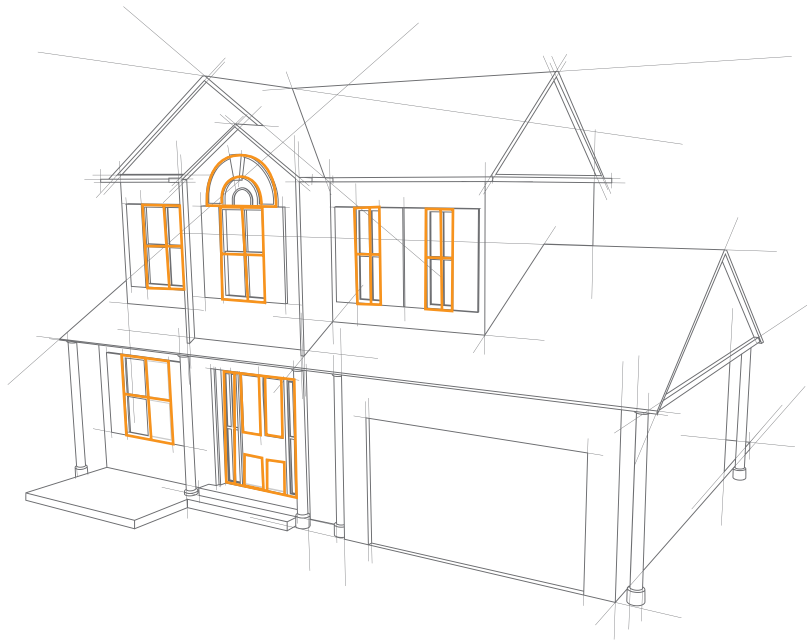
³⁴ See, Wittwer, Karen, “Beyond Auto-Enrollment: Auto-Escalation and Stretched Match,” PlanSponsor, July 8, 2015 (“PlanSponsor article”). See, also, “‘Stretching’ the Match Raises Contribution Rates,” Retirement Income Journal, December 1, 2010.

Constructing the future

Increasing the percentage of pay on which the match is based has been shown to increase employee deferrals dramatically.

If the employer uses the stretch match concept, this will not result in an increase in the cost to the employer. The resulting increase in employee retirement savings is significant.

Since the process of making this change requires very little employer effort, you have to ask yourself, what are you waiting for?



4

Adding the details: Automatic escalation

THE PERCEPTION

Employees will resent it if we force them to increase their deferral rate through automatic escalation. This will hurt employee morale.

THE REALITY

This simply isn't true.

Studies show that very few employees opt out when there is an automatic increase in their deferrals. They even suggest that employees appreciate having the decision made for them.³⁵

³⁵ PlanSponsor article.

This strategy addresses another obvious aspect of savings plans. That is, in most plans the principal source of employee retirement savings is their own deferrals and the earnings on those deferrals. So participants will have a better chance of securing a reasonably successful retirement the more they defer into the plan.

A second general concept is that participants set their own deferral rate, and the rate remains unchanged unless the participants affirmatively elect otherwise. Like automatic enrollment, automatic escalation reverses this concept. Using this mechanism, the deferral rate of participants in a plan is increased periodically without their affirmative election...unless they opt out.

Automatic escalation thus addresses another key concept of savings plans, which is increasing the amount of employee deferrals to increase retirement savings with the aim of producing a more secure retirement. Much like automatic enrollment, automatic escalation also sidesteps employee inertia.³⁶ Employees may have the best of intentions but they are also often distracted with their daily lives and may not pay close attention to their savings plan. Automatic escalation avoids that problem.

Implementation of this feature is also relatively simple. There must be a plan provision providing for the increases, and there must be notices to participants giving them the choice to opt out. In most plans that use the feature, deferrals are increased at the beginning of each plan year, though some employers choose to increase deferrals when employees receive pay increases, or at other times. But so long as the plan is administered by a competent plan provider,

and the plan sponsor provides necessary census data, the process is seamless, and will help participants accumulate more retirement savings than they would generally do on their own.

A common rate of annual increase is 1%, though there is no legal mandate or constraint on this percentage (except in the case “safe harbor” plans that must escalate at a minimum of 1% per year). A common ceiling is 10%, again because of the limit for “safe harbor” plans. Employers seem to use these figures out of a concern that it will upset their employees if they mandate a faster or higher increase, but multiple studies have shown that participants generally do not object to higher limits and the opt out rate is very low. Further, current data indicates that a 10% deferral rate can be expected to produce replacement income of about 70% at retirement, which when coupled with Social Security and personal savings is generally thought to be sufficient for a comfortable retirement.

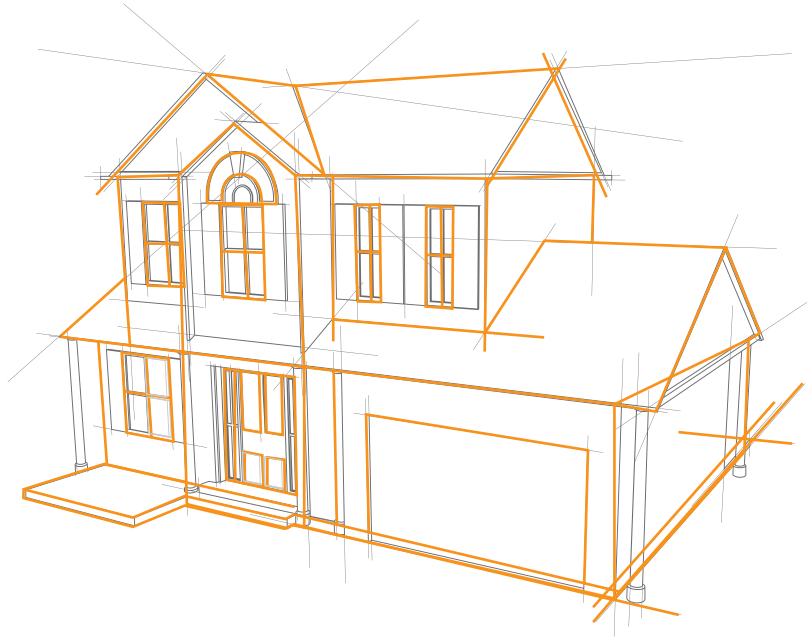
³⁶ Research has shown that workers automatically enrolled in a plan at a 3% deferral rate continue to contribute at the default deferral rate absent automatic escalation. 18 See, e.g., VanDerHei, Jack, “Increasing Default Deferral Rates in Automatic Enrollment 401(k) Plans: the Impact on Retirement Savings Success in Plans with Automatic Escalation,” Employee Benefit Research Institute, 2012.

Constructing the future

There are no significant impediments and automatic escalation provides significant benefits:

- The process for adopting and implementing the feature is simple.
- It benefits employees by increasing their deferrals, which will ultimately increase their retirement savings.
- Rather than resenting “interference” from their employer, employees seem to appreciate having someone keeping their best interest in mind by making sure they increase their deferral rate.
- To the extent it increases employee retirement savings, it may benefit employers by eliminating a source of concern among the employees.

With no downside and a number of positive upsides, you need to ask yourself, what are you waiting for?



5

Completing the structure: Re-enrollment

THE PERCEPTION

It's too much work, and besides, we don't need to do this because the plan is already working just fine.

THE REALITY

As with the other misperceptions, this is not true.

On the too much work point, because re-enrollment is no longer a new concept, the amount of work involved is quantifiable and most of it is handled by the plan provider once the employer makes the decision to go forward. The employer has to decide what the new “default” deferral rate will be and what QDIA to use – and must make sure notices are sent out to the employees – but the employer’s involvement is fairly limited.

The second point is possible though doubtful. Unless 70% to 80% of the participants are invested in well-structured portfolios and are deferring at a 10% to 15% deferral rate, the statement is probably not true. Employers need to take a close look at how participant accounts are invested and what the deferral rates are. If many participants are deferring at less than the amount needed to get the match and a substantial amount of the assets is in fixed income, stable value or money market funds, the “just fine” conclusion is just not true.

Most defined contribution plans provide for participant direction of their accounts. This is based on an assumption that participants know how to make prudent deferral rate and investment decisions, that is, decisions that will generate adequate retirement savings, augmented by a reasonable return on their money. Plan sponsors go to great lengths to select a prudent array of investment choices for their participants, provide them with information about those investments, offer education and make investment advice available. As new, better investments products are introduced, they add them to the plan. They take their jobs seriously and want to help. Unfortunately, most participants lack the time, interest, education or experience to determine the proper deferral rate and to give directions that will maximize their retirement savings in order to have a secure retirement. All too often, they take the “safe” course: they defer too little and direct that their accounts be invested in a stable value or money market fund.

The concept behind re-enrollment is that it will help even those employees who are engaged enough to affirmatively direct their own accounts to achieve a secure retirement. Re-enrollment might better be called “re-election” because employees who are already participants in the plan are being asked to

reconsider their prior decisions. That is, they are asked to elect a new, higher deferral rate and to make a new investment decision regarding their accounts. If they do not, their prior savings and investment decisions will be overridden. They will be treated as defaulting participants and their deferral rate will be adjusted to a new rate specified by the employer (except in cases where they already defer at a higher rate) and their account will be invested in the plan’s QDIA. As with automatic enrollment and automatic escalation, the participant has the ability to opt out, to tell the plan sponsor to leave the account the way it is. But in many cases, employees do not opt out and permit their accounts to be defaulted into the higher savings rate and the QDIA. The result is more secure, better-invested participants. Because of this, some would call re-enrollment a best practice.³⁷

Re-enrollment best practice

More properly called “re-election,” participants are asked to make new choices about their deferral rate and investment selection.

They can opt out, but if they take no action, here’s what happens:

- Their deferral rate is increased to one designed to produce a more secure retirement (at least at the rate needed to maximize the employer match); and
- Their account is invested in the plan’s QDIA.

We call this a “best practice” because it achieves the dual goals of helping participants achieve a more secure retirement, and of providing greater fiduciary protections to the employer.

³⁷ In this context, “best practice” refers to steps that can be taken by a fiduciary that, while not required by ERISA, help achieve better results for participants – which is consistent with the ERISA requirement for fiduciaries to act in the interest of participants at all times – and provide protections to the employer at the same time. 21

A Plan Sponsor's fiduciary responsibility goes beyond just selecting prudent options for the employees to select; it extends to acting in the interest of the participants (sometimes called the duty of loyalty), for the exclusive purpose of providing benefits. This means that the responsibility extends to participant investing, even when the plan has delegated that ability to participants and the participants have directed the investments. While there is some protection for fiduciaries if the plan is a 404(c) plan (that is, the plan complies with the notice and other requirements of ERISA Section 404(c) and the related DOL regulation), with few exceptions, the employer does not escape this duty.

Thus, a benefit of re-enrollment is that, with respect to participant investing, it often gives the employer the protection of the QDIA safe harbor.³⁰ Even if the plan investment lineup is expanded to offer well-managed alternatives, employee inertia often means that the accounts remain invested the way they were when the employee originally made his or her investment choices. That is, most participants who have already directed their investments are unlikely to act to move their accounts to the newly offered options.³⁹ For fiduciaries who want to improve the quality of the investing of current participants, re-enrollment, together with the QDIA rules, affords that opportunity.

But does the QDIA safe harbor really work this way? Does it protect fiduciaries where they use the re-enrollment process to force participants to make a new investment decision – even if they made one in the past – and if they don't, default them into the QDIA? The answer is simple: it does. Though the QDIA regulation was designed principally to address automatic enrollment plans, its applicability to

re-enrollment is supported by language in the preamble to the QDIA regulation and has been upheld in a 2012 court decision.⁴⁰ Thus, investment re-enrollment can help participants be better invested, thus leading to a more secure retirement. It can also help the employer by providing QDIA fiduciary safe harbor protection.

What about the other prong of re-enrollment, the requirement for a participant to re-designate his or her deferral rate? The fiduciary obligation does not extend to making sure that participants defer any specific amount or an adequate amount, and there is no safe harbor for what is essentially an automatic escalation of the deferral rates of many participants. Nevertheless, for plan sponsors who are committed to helping their participants achieve a more secure retirement, savings rate re-enrollment provides benefits described earlier in the discussion of automatic enrollment and automatic escalation.

The process for implementing re-enrollment is, like the other approaches outlined in the blueprint, not overwhelming. Employers should review their plan documents and summary plan descriptions to make sure there are no prohibitions or limitations that say once a participant has made savings and investment decisions, only the participant can make changes, or that impose other limitations.⁴¹ Even if they do, the documents can easily be amended. In addition, a notice must be given to participants not less than 30 days prior to the date by which participants are required to make their savings and investment election or be defaulted into the new deferral rate and the QDIA, though some sponsors elect to provide more notices in order to ensure that the participants understand their options and what will happen if they do not re-designate the investment in their accounts.

³⁸ ERISA Section 404(c)(5) and ERISA Regulation Section 2550.404c-5.

³⁹ 2013 Survey Findings, at page 7.

⁴⁰ See Appendix A.

⁴¹ *Falcone v. DLA Piper US LLP Profit Sharing Plan and 401(k) Savings Plan Committee*, No. 09-5555 (N.D. Cal. filed Nov. 23, 2009, terminated Sept. 2, 2011).

Constructing the future

There are no significant impediments and re-enrollment provides significant benefits:

- The process for implementation is simple.
- Employees receive the benefit of greater deferrals and better investing. This happens either because they are required to focus on how they are saving and how their accounts are invested or because they permit the decision to be made for them. And that leads to higher deferrals and money invested in the QDIA.
- The employer receives the benefit of better invested participants and, in many cases, the protection of the QDIA safe harbor.

With no downside and positive upsides, you need to ask yourself, what are you waiting for?

Conclusion

The Blueprint for Retirement Success is intended to accomplish three goals:

- 1 Overcome employee inertia;
- 2 Help employers have a more productive, engaged and committed workforce, by relieving employee economic stress and producing better retirement outcomes; and
- 3 Provide fiduciary protections and safeguards for employers.

The Blueprint also shows that the objections most often raised to the use of these solutions – they are too expensive, they create more risk, they aren't necessary, they are too much work, they will upset the employees – are misperceptions that have grown out of misinformation and misunderstanding. Indeed, the Blueprint is premised on provisions of ERISA, the Code and government regulations that provide a firm foundation for each element that goes into the retirement success structure.

The solutions described are cost-effectively, easily implemented and legally supported steps that can be taken to build a better outcome for employees. And in

taking these steps, employers can achieve significant benefits as well.

Each solution addresses a specific concern:

- Automatic enrollment – getting employees into the plan so that they start saving for retirement;
- Successful default investing – enhancing employee investing by selecting QDIAs that meet the needs and objectives of the workforce...and provide employers the greatest fiduciary safe harbor protection;
- Effective employer matching – using an easily-implemented, cost-effective incentive to encourage employee to help themselves by increasing their deferrals;
- Automatic escalation – increasing employee deferrals for those who don't spend the time managing their own accounts effectively, in order to improve the retirement outcome;
- Re-enrollment – enhancing employee savings and investing and providing fiduciary protection.

Like building a house, the end result is stronger and more successful when the contractor uses the entire blueprint instead of individual pieces.

Appendix: A legal analysis

ERISA Requirements Generally

ERISA Section 404(a) states that fiduciaries must act “solely in the interest of the participants,” (the duty of loyalty) and must carry out their duties “for the exclusive purpose” of providing benefits and defraying reasonable expenses of administering the plan (the exclusive purpose requirement). (In this paper, for ease of reference we generally use the term “employer” or “plan sponsor” to refer to the fiduciary of ERISA plans; the fiduciary functions are generally carried out by “plan committee” to refer to the officers, managers and directors of the plan sponsor who often make up the plan committee.) Thus, a plan sponsor must make decisions in the context of providing retirement benefits and ensuring that the costs of the plan are no more than reasonable. This does not mean that they have an obligation to administer their plans to provide any specific level of benefits, only that they act in a way that will help the participants in achieving retirement readiness.

Plan sponsors fulfill these duties by following a prudent process. ERISA requires fiduciaries to act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the context of an enterprise of a like

character and with like aims ...”⁴² Stated differently, the success of fiduciary conduct is judged under the “prudent man rule.”⁴³ It means that a fiduciary be “familiar with such matters” – i.e., the management of a retirement plan – which sets the ERISA prudence requirement apart from the test of what an average person would do in managing his own affairs.

The focus of the DOL and the courts when interpreting the prudent man rule has been on process rather than results. A DOL regulation related to selecting investments describes the process as requiring that fiduciaries give “appropriate consideration” to information they know or should know is relevant to the decision and then act accordingly in making their decision.⁴⁴ In essence, the DOL described four steps:

- 1 Determine the issues that are relevant to the decision to be made;
- 2 Conduct an investigation of facts needed to evaluate those relevant issues so that the fiduciaries are properly informed about the decision to be made;⁴⁵
- 3 Analyze the information gathered through the investigation;⁴⁶
- 4 Make a decision that is reasonably connected to the information analyzed.

⁴² Id. Emphasis added.

⁴³ ERISA §404(a)(1)(B).

⁴⁴ 29 C.F.R. §2550.404.a-1(b)(1).

⁴⁵ See, generally, *Riley v. Murdock*, 890 F.Supp. 444, 458 (E.D.N.C. 1995).

⁴⁶ See, generally, *Fink v. National Savings and Trust Company*, 772 F.2d 951, 962 (D.C. Cir. 1984).

Using these steps should produce an “informed and reasoned” decision – or, in other words, a prudent decision

All this translates into the fact that fiduciary conduct is judged more on process and less on outcomes. While results are important, courts will generally ask whether the fiduciaries engaged in an appropriate process, which one court has described as “at the time they engaged in the challenged transaction, [whether the fiduciaries] employed the appropriate methods to investigate the merits” of the transaction.⁴⁷

One of the obligations of fiduciaries under ERISA is to prudently manage a plan’s investments.⁴⁸ That is, the plan sponsor must prudently select and monitor the investments offered by a defined contribution plan and is also responsible for the prudent investing of participant accounts.⁴⁹ As to the latter, the obligation is not limited to the accounts of participants who fail to direct their investments, where the sponsor must decide how the money in those accounts is to be invested. The sponsor’s investment obligation also applies to the accounts of participants who direct their investments (unless the plan complies with all of the 404(c) conditions).

In participant-directed plans, plan sponsors face a dilemma: plan assets, including participant accounts, must be invested according to generally accepted investment theories, such as modern portfolio theory,⁵⁰ and in a manner that meets the needs of the participant and is designed to avoid large losses. In other words, participant accounts must be prudently invested; but, for the most part, participants do not have the ability

to do this.... because of lack of investment expertise, time or interest. As a result, fiduciaries may turn to professionally designed investment options, including managed accounts, risk-based investments (balanced funds) or age-based investments (TDFs).

To assist plan sponsors, ERISA provides several “safe harbors”, that is, provisions that provide protection to fiduciaries so long as they follow specific requirements. The first and most commonly recognized safe harbor is ERISA Section 404(c).⁵¹ If a plan complies with various disclosure and other requirements, fiduciaries are relieved of liability for investment decisions made by the participants. The disclosure requirement incorporates into the 404(c) regulation the participant disclosure rules under ERISA Regulation Section 2550.404a-5.⁵² Thus, to the extent a plan sponsor complies with the participant disclosure rules, it has gone a long way in satisfying the 404(c) requirements. But there are others in order to obtain the 404(c) protection, including the requirement to offer a broad range of investment alternatives and certain other disclosures beyond the 404a-5 disclosures.

A second fiduciary safe harbor can be obtained if an investment advisor (a bank, insurance company or registered investment advisor) is given discretion over the management of investments.⁵³ In the context of participant investing, to obtain this protection, fiduciaries must select an investment advisor who, if used by a participant, is given discretionary control of the participant’s account and manages it on an ongoing basis.

⁴⁷ *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir.1984); cert. denied sub nom, *Cody v. Donovan*, 469 U.S. 1072, 105 S.Ct. 565, 83 L.Ed.2d 506 (1984).

⁴⁸ ERISA §404(a)(1)(B) and ERISA Regulation §2550.404a-1.

⁴⁹ ERISA §409(a). See also, Department of Labor’s Amicus Brief in *Hecker v. Deere*: “It is the fiduciary’s responsibility to choose investment options in a manner consistent with the core fiduciary duties of prudence and loyalty. If it has done so, section 404(c) relieves the fiduciary from responsibility for the participants’ exercise of authority over their own accounts. If, however, the funds offered to the participants were imprudently selected or monitored, the fiduciary retains liability for the losses attributable to the fiduciary’s own imprudence.”

⁵⁰ See, e.g., the preamble to the DOL’s final regulation on qualified default investment alternatives, 72 FR 60451, 60461 (2007).

⁵¹ Technically, this is not a safe harbor but a defense to a claim of breach of fiduciary duty. Since it is commonly referred to as a “safe harbor,” however (except by the DOL), we have elected to use that term here as well.

⁵² See ERISA Regulation §2550.404a-5.

⁵³ See ERISA §§3(38), 402(c)(3) and 405(d).

The third most common safe harbor arises in the default context, that is, when a participant fails to exercise control over his account in a plan that permits him or her to do so. When a participant “defaults,” the plan sponsor must prudently invest the participant’s account. To assist in this obligation, ERISA provides a safe harbor so long as the plan complies with specific requirements.⁵⁴ These include a notice requirement and the selection of an appropriate default investment, i.e., a “qualified default investment alternative” or QDIA. Once these requirements are met, the defaulting participant is deemed to have exercised control over his account, so that the fiduciaries are not responsible for whether the investment is otherwise appropriate for the participant (e.g., whether the QDIA suffered losses compared to the result of a risk-free investment).⁵⁵ The key to obtaining this safe harbor, however, is that there be a default by a participant.

Two of the elements of the blueprint discussed in the paper are not requirements under ERISA, are not fiduciary decisions and do not require a safe harbor to implement. That is, plans are not required to provide a match under ERISA or to provide for automatic escalation. Both of these are business (or “settlor”) decisions by the plan sponsor, though they can and often do provide benefits to the employer.

The following sections discuss the elements of the blueprint that do invoke the ERISA fiduciary rules and these safe harbors.

Automatic enrollment

The decision to adopt automatic enrollment is not a fiduciary one. That is, the failure to implement automatic enrollment in a plan is not a breach of fiduciary duty. As we have seen in the body of this

paper, there may be a number of valid reasons for and benefits of adopting automatic enrollment, but it is not required. However, where a plan sponsor elects to adopt this feature, ERISA provides various protections.

The laws of many states make it impermissible to deduct funds from a participant’s pay without a specific authorization, except for things like income taxes and court ordered seizures of funds.⁵⁶ To make automatic enrollment plans permissible, the ERISA pre-emption provision was amended so that participants may be defaulted into the plan and have funds deducted from their pay without affirmative consent.⁵⁷ But what happens to those deferrals? As discussed earlier, they have to be invested, and the plan sponsor is responsible for making sure they are prudently invested.

ERISA deals with this concern in Section 404(c)(5), the QDIA safe harbor. While the regulations under this section make it clear that fiduciaries are responsible for the prudent selection and monitoring of a QDIA, they are not responsible for the investment performance of the QDIA.

In implementing automatic enrollment, the plan sponsor makes sure that employees get into the plan and start deferring and make sure that their funds are prudently invested in a professionally managed, diversified fund or portfolio that is intended to provide them with meaningful investment growth and protection from large losses.⁵⁸

Successful default options

The regulation under ERISA Section 404(c)(5) requires that QDIAs meet various requirements. They must constitute a registered mutual fund or be managed by

⁵⁴ ERISA §404(c)(5).

⁵⁵ *Bidwell v. University Medical Center, Inc.*, 685 F.3d 613 (6th Cir. 2012).

⁵⁶ See, e.g., California Labor Code Sections 221-224.

⁵⁷ ERISA Section 514(e).

⁵⁸ See ERISA Regulation Section 2550.404c-5(e)

a discretionary investment manager and must be a target date fund or portfolio, balanced fund or portfolio or a managed account service. The fund, portfolio or managed account must also meet the following requirements:

- Apply generally accepted investment theories,
- Be diversified so as to minimize the risk of large losses,
- Be designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures.

In the case of target date funds, they must be based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy and must change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age. Managed account services must also take into account these same factors and use only the plan's designated investment alternatives to be deemed qualified. Balanced funds must appropriate for the participants of the plan as a whole.

The decision on which type of fund or service to select does not require a fiduciary process; but once the category has been identified, the selection must be prudent. As with any other investment alternative selected for the plan, the plan sponsor must follow a prudent process, which means gathering relevant information about competing products, assessing that information and making an informed and reasoned decision. The DOL has provided assistance with this process in the context of target date funds with a 2013 "Fact Sheet" entitled Target Date Retirement Funds -

Tips for ERISA Plan Fiduciaries. The DOL recommends that plan sponsors:

- Determine the needs of the plan and participants;
- Assess the appropriateness of a "to" versus "through" strategy;
- Understand the fund's glide path;
- Establish a process for comparing and selecting TDFs;
- Establish a process for the periodic review of selected TDFs;
- Understand the fund's investments – the allocation in different asset classes (stocks, bonds, cash), individual investments, and how these will change over time;
- Review the fund's fees and investment expenses;
- Develop effective employee communications; and
- Document the process.

Most of these same concepts apply to balanced funds and managed account services as well. One thing that the DOL does not mention but that may be prudent for plan sponsors to consider is to engage a financial advisor or plan provider for assistance in gathering and assessing the information.

Re-enrollment

A common perception is that there is no legal support for the concept of re-enrollment or the conclusion that it can provide fiduciary protection to a plan sponsor under the QDIA provisions of ERISA. This perception is not supported by the legal authorities.

The DOL indicated in the preamble to the QDIA regulation that the rule applied to several situations other than automatic enrollment, where participants most commonly default in the selection of investments for their accounts. It stated that the protection applies to:

The failure of a participant or beneficiary to provide investment direction following the elimination of an investment alternative or a change in service provider, the failure of a participant or beneficiary to provide investment instruction following a rollover from another plan, and any other failure of a participant to provide investment instruction.⁵⁹ [emphasis added]

It then added: Whenever a participant or beneficiary has the opportunity to direct the investment of assets in his or her account, but does not direct the investment of such assets, plan fiduciaries may avail themselves of the relief provided by this final regulation, so long as all of its conditions have been satisfied. [Emphasis added.]⁶⁰

The United States Court of Appeals for the 6th Circuit has held that the fiduciaries of a re-enrolled plan were entitled to the QDIA fiduciary safe harbor.⁶¹ Two participants who were reenrolled in their plan, Bidwell and Wilson, argued that QDIA protection applied only to participants' accounts where there were not existing participant investment directions. The court disagreed, explaining:

In enacting the Safe Harbor provision, the DOL made clear that it did not agree with Bidwell's and Wilson's interpretation of the regulation. In the preamble to the final regulation, the DOL stated explicitly that "the final regulation applies to situations beyond automatic enrollment" including circumstances such as "[t]he failure of a participant or beneficiary to provide

investment direction following the elimination of an investment alternative or a change in service provider, the failure of a participant or beneficiary to provide investment instruction following a rollover from another plan, and any other failure of a participant or beneficiary to provide investment instruction." 72 Fed. Reg. 60452–01, 60453 (Oct. 24, 2007). Thus, the DOL emphasized that "[w]henever a participant or beneficiary has the opportunity to direct the investment of assets in his or account, but does not direct the investment of such assets, plan fiduciaries may avail themselves of the relief provided by this final regulation, so long as" the other Safe Harbor requirements are satisfied. *Id.* (emphasis added). The DOL was clear also that the "opportunity to direct investment" includes the scenario where a plan administrator requests participants who previously had elected a particular investment vehicle to confirm whether they wish for their funds to remain in that investment vehicle. [Emphasis added.]

This means that where participants are required to make an investment decision, even if they have already made one in the past (and the notice and information requirements of the regulation are met), the QDIA fiduciary protection is available. This is confirmed in the following additional language from the court's opinion:

It is the view of the Department that any participant or beneficiary, following receipt of a notice in accordance with the requirements of this regulation, may be treated as failing to give investment direction for purposes of paragraph (c)(2) of § 2550.404c–5, without regard to whether the participant or beneficiary was defaulted into or elected to invest in the original default investment vehicle of the plan.

* * * *

⁵⁹ Preamble to the QDIA Regulation, 71 FR 60453

⁶⁰ Preamble to the QDIA Regulation, 71 FR 60453.

⁶¹ *Bidwell v. University Medical Center, Inc.*, 685 F.3d 613 (6th Cir. 2012).

In essence the DOL explained that, upon proper notice, participants who previously elected an investment vehicle can become non-electing plan participants by failing to respond. As a result, the plan administrator can direct those participants' investments in accordance with the plan's default investment policies and with the benefit of the Safe Harbor protections. [Emphasis added.]

As a result, it is clear that the safe harbor protection of the QDIA provisions of ERISA protect plan sponsors that elect to re-enroll their participants.

About the authors

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