Automation: 3 Steps to a High Performance Plan

EXECUTIVE SUMMARY

As more and more American workers rely on their defined contribution plan as their primary source of retirement assets, providers and employers need to find ways to help employees maximize this benefit. To do this, providers and employers must help employees enroll, invest appropriately, and save aggressively. Historically, the industry has focused on education and communication to do this; unfortunately, coverage and effectiveness have been limited. Even the best communication has a hard time addressing some key barriers to action: inertia and procrastination. These are strong tendencies and require a strong, comprehensive solution.

Automation offers just such a solution. Not only does it help drive participant savings, it also offers an efficient way to administer the retirement benefit. Moreover, it can help with the results of non-discrimination testing. Now that the Pension Protection Act (PPA) is law, employers have more information and direction on implementation. As a result, more and more plan sponsors are automating their retirement plans.

The Profit Sharing Council of America (PSCA) reports that more than half of large plans now use automatic enrollment and usage for small companies doubled in the past year.[1] In addition, a recent Hewitt survey found that more than half of plan sponsors will be considering automated features in 2008.[2]

This white paper offers some suggestions and best practices to consider when adopting plan automation. With a little forethought and planning, you can design and implement an effective, efficient, and appreciated automated plan.

	Automatic Enrollment (AE)	Automatic Deferral Increase (ADI)	Default to Target Date Investment Option
Benefit	• Increase participation • Helps employees start saving sooner • Helps hard-to-reach employees • Can help with testing	• Increases participant savings • Helps hard-to-reach employees	• Helps employees with little knowledge of investing • Greater return potential than stable value or money market options
Best Practice	• Adopt a default deferral rate of 6% or higher • Implement AE for existing as well as new employees • Include ADI	• Implement the service as “opt-out” • Recommend increases of 2% annually	• Follow up with investment education for interested employees

[1] *The Profit Sharing Council of America. 2008. 51st Annual Survey.*

[2] *Research Report: How Well Are Employees Saving and Investing in 401k Plans: 2006 Hewitt Universe Benchmarks.*

Step One: Think It Through

Why Automate?

97% of automatically enrolled participants and 90% of automatically enrolled participants who opted out of the plan agreed that they were satisfied with the enrollment process.[3]

Automation is extremely effective in helping employees start saving, saving more, and investing appropriately. Automatic enrollment can increase participation rates by more than 30%.[4] It is also effective on groups of employees that are traditionally harder to reach: younger employees and lower income employees. Research found that participation was 21 percentage points higher for workers with less than $20,000 in annual salary under automatic enrollment. Moreover, for workers ages 20-29, participation was 22 percentage points higher with automatic enrollment.[5]

Review Plan Goals and Expectations

Before making any change to your plan, it's a good idea to review and record your plan goals. This may sound simple, but it provides a good foundation for evaluating any potential plan changes. Do you want this benefit to reach as many people as possible or do you want it to reward those who were motivated enough to enroll on their own?

Are there any existing plan issues you are looking to address, such as low enrollment or savings rates? Automation is a quick and efficient way to change the participant behaviors driving many of these issues. It is the most effective way to increase enrollment and can help with plan testing. Implementing automatic enrollment (AE) can increase participation by an average of more than thirty percentage points.[6] Automatic deferral increase is the most effective way to increase savings rates and consistently grow plan balances.

Calculate Cost

The retirement plan is a great employee benefit, but it comes with a cost. Increasing enrollment means increasing expenses if you offer a match. There are also other related costs that are harder to quantify. Are there payroll interface changes that need to be made? What about changes in processes or procedures? Your provider can often help with these issues. They can also give you an assessment of the cost of the increased match. Cost is rarely prohibitive, but it is definitely something to be considered. It's primarily a question of how you want to allocate your compensation dollars.

Consider Data and Processes

What information do you currently give to your retirement plan provider? Full automation requires sharing eligibility and deferral data. It also requires data maintenance and review. It's worth the effort to provide this information. Your provider can then give you more value-added services and information. For example, by outsourcing salary deferral maintenance to your provider, you can outsource the work associated with collecting and maintaining deferral percentage change requests from individual participants. At the same time, your provider can combine this information with the rest of the data within the plan and analyze it. That information can then be used as an index to understand the effectiveness of plan initiatives and identify trends. You get benchmark data and reporting you can use to identify ways to improve the plan.

[3] *Harris Interactive Inc. Public Relations Research. "Retirement Made Simpler." Prepared for AARP, FINRA, and the Retirement Security Project 2007.*

[4] *MassMutual Data 2006-2007.*

[5] *Research Report: How Well Are Employees Saving and Investing in 401k Plans: 2006 Hewitt Universe Benchmarks.*

[6] *MassMutual Data, 2007.*

Step Two: Design It Right

The Best Plans Plan Well

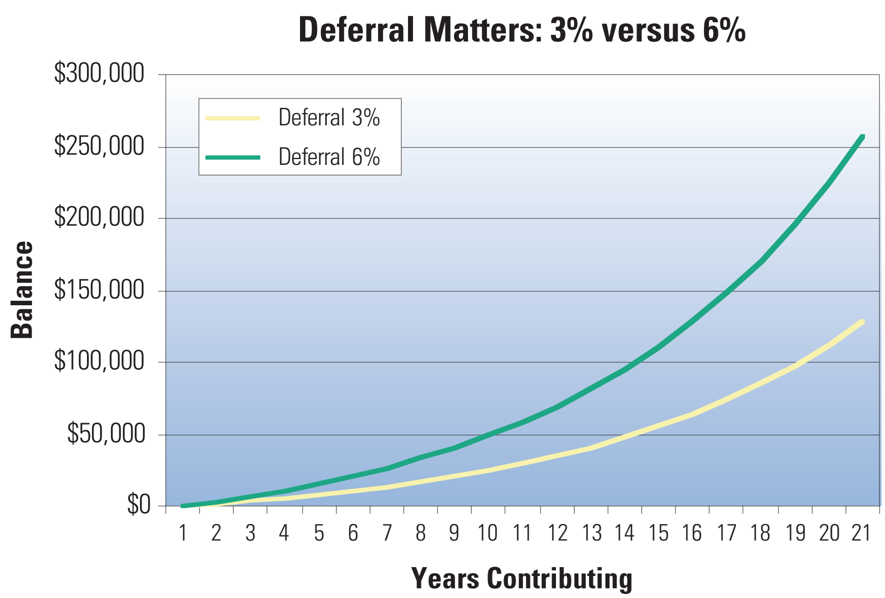
Once you've decided that automation is right for your plan, you have to make your design decisions. Automation isn't one size fits all, but there are standards set out by the Pension Protection Act (PPA) and some best practices you may want to consider.

Don't be Afraid of High Default Rates

Currently, the majority of plans have a default savings rate of three percent.[7] That doesn't mean that this is the appropriate rate for the participant, though. Despite this, many participants think the default rate is a recommended savings rate. They assume you select the rate based on their needs, not the match or other factors. Participants think, "If my employer enrolls me at 3%, that's probably what I should be saving."

Plan design largely drives contribution behavior. In one study, plan participants enrolled with an average deferral rate of 7.3%. After changing to automatic enrollment with a default rate of 3%, the average deferral rate among new enrollees dropped to 4.4%.[8]

Another thing to consider is that many participants don't change from this default rate on their own. Inertia sets in and their attention turns to other things. For this reason, it's good to anchor the number as high as you can. We recommend a rate of at least six percent. The difference between 3% and 6% really adds up over time.



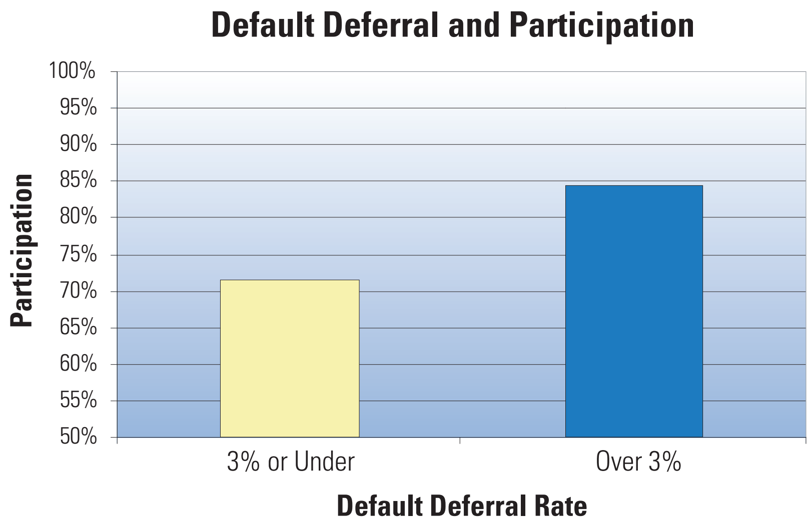
Projection based on $50,000 annual compensation and 13% annual yield on investment.

[7] *MassMutual Data 2007.*

[8] *Madrian, Brigitte C. and Dennis F. Shea. 2001. "The Power of Suggestion: Inertia in 401k Participation and Savings Behavior." Quarterly Journal of Economics. 116 (4): 1149-1187.*

Frequently, sponsors adopt a modest default because they believe their employees won't accept a higher rate. Our research suggests that this is not so. Consider the example of one of MassMutual's textile industry clients that boasts an 8% default deferral rate and 96% participation.

In fact, MassMutual plans that use a default higher than three percent actually have higher participation rates than those defaulting three percent or less.



(MassMutual Data 2007.)

Automatic Deferral Increase is a Must

Enrollment at a higher default rate is the first step on the path to a secure retirement. Considering most experts recommend an income replacement rate of 70% or higher, many participants are not saving enough, even if they are enrolled at 6%.

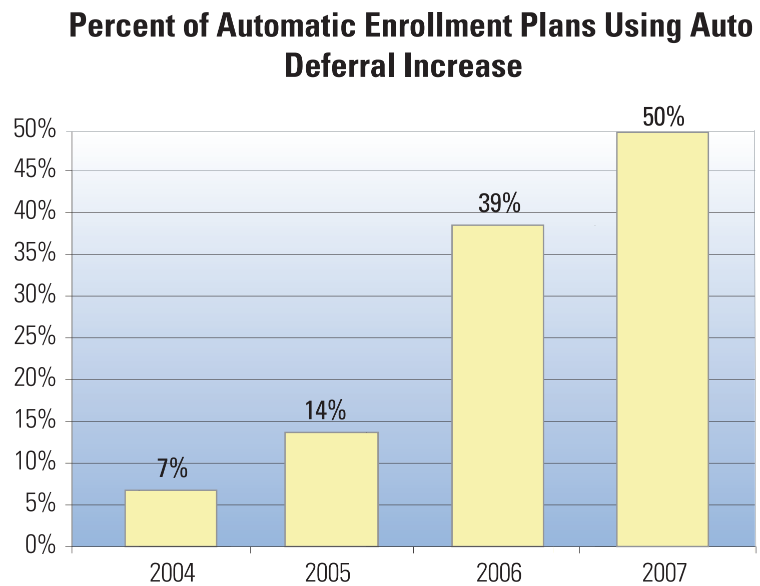
An important study asked plan participants to compare their deferral rates with the rate they thought they would need to retire. More than two-thirds characterized their savings rate as "too low." More than a third of this "too low" group said they intended to increase their deferral rates but only 12.5% actually followed through and increased.[9]

Inertia, or the tendency to do nothing, is a powerful inclination in all of us. Historically, it's been detrimental to retirement planning. However, it can be turned around to work *for* us, instead of against us. Automatic deferral increase (ADI) is an excellent example of this. ADI automatically increases employees' deferral rates at regular intervals, usually 1% annually.

More and more plans are adopting the ADI feature. According to the most recent Profit Sharing Council of America Survey, half of plans with automatic enrollment also have ADI[10]. This number is expected to grow in the coming years.

[9] *Choi, James J. and David Laibson and Brigitte C. Madrian and Andrew Metrick. 2002. Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance." Pension Research Council Working Paper 2002-3.*

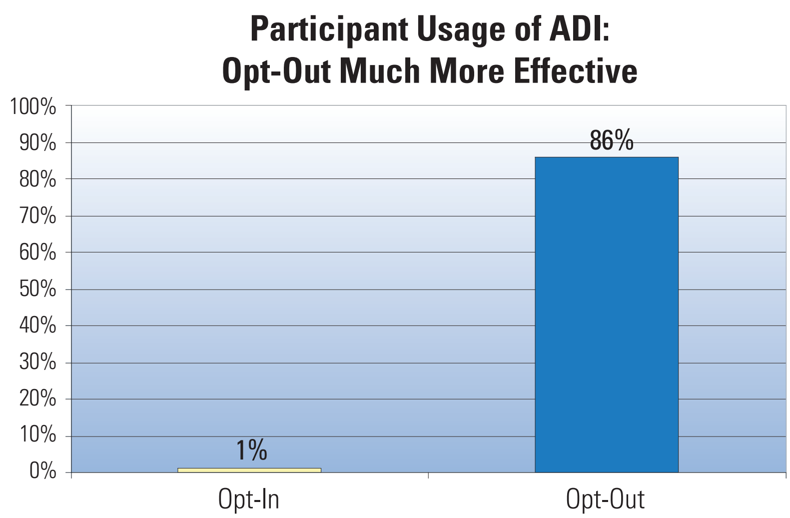
[10] *The Profit Sharing Council of America. 2008, 51st Annual Survey.*



(Data from 48th through 51st Annual PSCA Surveys)

Opt-out, Not In

To be maximally effective, ADI needs to be an opt-out decision. Compare the ADI adoption rates of "opt-in" plans versus "opt-out" plans: 86% of opt-out participants are using the service versus one percent of "opt-in" participants.



(MassMutual Data 2007.)

Not only is opt-out more effective, but participants also appreciate the service. A survey of automatically enrolled participants asked them to evaluate the automation process. 95% of participants agreed that automatic enrollment made saving for retirement easy. Perhaps most interestingly, 97% of automatically enrolled participants and 90% of automatically enrolled participants *who opted out of the plan* agreed that they were satisfied with the enrollment process.[11] They were not upset to be automatically enrolled, even if they opted out.

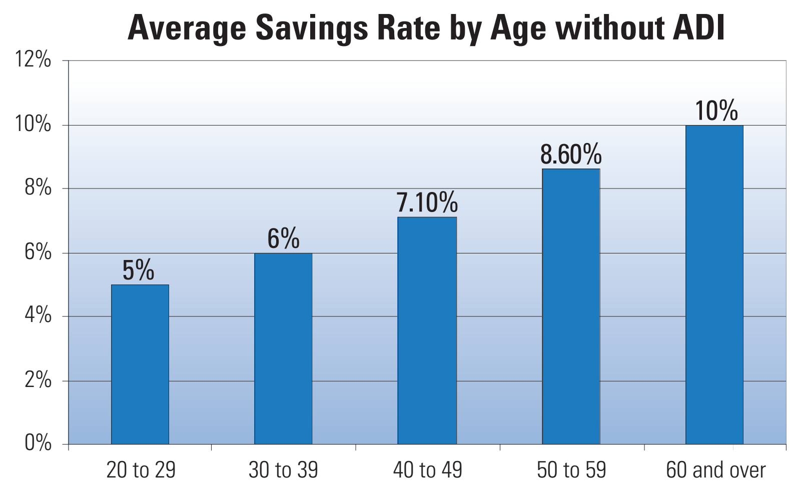
[11] *Harris Interactive Inc. Public Relations Research. "Retirement Made Simpler." Prepared for AARP, FINRA, and the Retirement Security Project 2007.*

Issue	Automated Solution
Enrollment Inertia Decision paralysis Procrastination Low Enrollment	**Automatic Enrollment** Eligible employees are enrolled in the plan automatically unless they opt out within a specific time period.
Investment Selection Little investment knowledge Fear of making a bad decision Lack of diversification	**Automatic Investment Selection** Unless they make an alternative selection, employees are defaulted into pre-selected age based target retirement investment option
Setting and Adjusting Savings Rate Not set according to retirement asset or income replacement needs Not changed or reviewed regularly	**Automatic Deferral Increases** Increases employee deferral rates by a set amount at regular intervals, usually 1% or 2% annually or with pay raise. Employees can override.

Consider enrolling non-participants

Many plans that elect automatic enrollment implement it for new employees only. You should consider re-enrolling all eligible employees. Oftentimes, enrollment is only publicized or discussed at hire or first eligibility. Employees who decline at these decision points should be re-solicited or enrolled. Circumstances and intentions change, and automatic enrollment may be just the push they need to start saving. Health care benefits have an annual enrollment drive; should retirement plan benefits be any different?

Re-enrollment can be especially helpful for younger participants. 85% agreed that automatic enrollment allowed them to start saving earlier than planned.[12] Couple enrollment with ADI, and you can really help address the lower savings rates of younger employees



(MassMutual Data 2007.)

Your health plan offers annual enrollment – shouldn't your retirement plan?

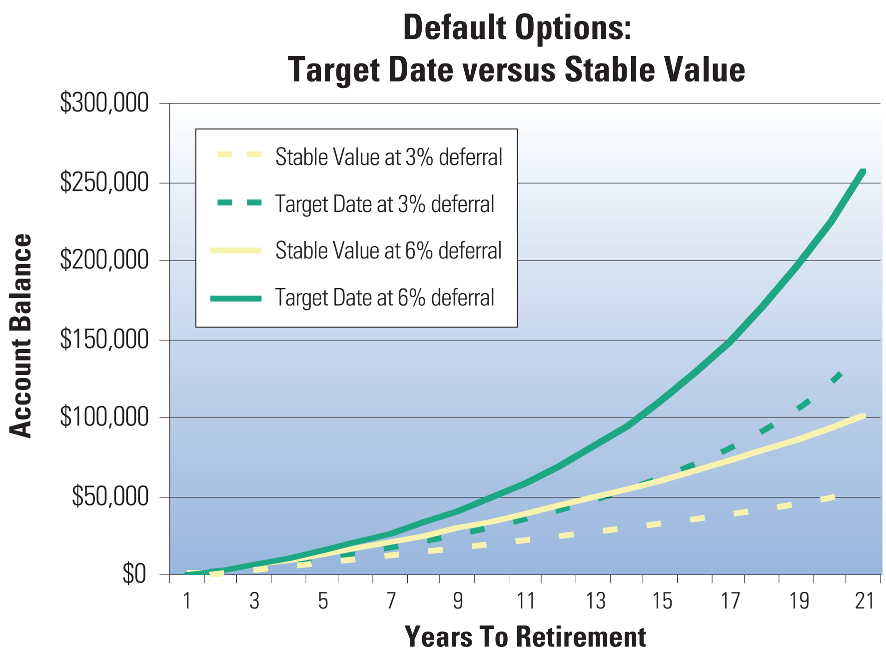
Default to Target Investment Option

Historically, sponsors have selected default investment options which preserve principal, usually a stable value or money market fund. These options protect against large-scale market losses but carry the risk that earnings will not keep pace with inflation. This can be harmful to participants over the long term because many never change their default asset allocation.

The PPA provides plan sponsors with fiduciary relief for contributions invested into default options that offer some direct exposure to equities through, among other alternatives, asset allocation options that align with a participant's anticipated date of retirement. These target date investment options provide a professionally managed portfolio with an automatic roll-down process that invests more conservatively over time. The target date option is designed to provide a better return over time. The differences in final balances can be substantial.

[12] *Ibid.*

Another way to increase balances while taking advantage of inertia is to couple the default fund with a higher default savings rate. The chart below compares projections between stable value and target date investment options with different default deferral rates. The impact of the higher default and target date default is clear: more assets for the participant at retirement.



Projection based on $50,000 annual compensation and 13% annual yield for Target Date option and 5% for stable value option.

Step Three: Engage and Educate

You've Put Them on the Path to a More Secure Retirement: Now What?

Congratulations! Full plan automation is the most effective way to get employees saving, investing appropriately, and saving more. You and your provider have communicated the changes, the options and the benefits. Your enrollment and savings rates are trending upward. You are comfortable that your fiduciary duties are fulfilled and your employee satisfaction is high. Now what?

Review Communication Plan and Goals

Moving to automation changes your plan's communication needs. Resources that formerly had been used to explain the benefits of enrolling or increasing savings can now be used on higher level education and engagement. You can make sure your participants are familiar with and use the available planning tools. You can concentrate on helping them understand their investment options and develop a strategy. The more they understand their needs and start actively planning, the more prepared they are likely to be at retirement.

Track the Metrics to Understand Changes

Be sure to ask your provider to track and show you the changes in your plan's metrics. These should include key measures like participation, deferral rate and investment allocation but should also include plan activity and demographic characteristics. You will not only be able to gauge the success of automation, but you will learn more about your employee population. You can better understand their communication preferences. This information can help you and your provider develop effective communication campaigns that address higher level objectives.

To learn more about MassMutual's retirement education and programs, please contact your MassMutual Retirement representative or plan advisor. You can also reach us at 1-877-333-4356. www.massmutual.com/retire

Conclusion

Automation is an efficient way to administer your retirement benefit, meet your plan goals and help your employees save for retirement. It is an extremely effective tool to help employees accumulate sufficient retirement income. Considering that defined contribution plans have become the primary vehicle for millions of American workers, providers and employers need to take every opportunity to facilitate saving. Ask your provider or financial professional to help you evaluate automated features and figure out if they're right for your plan.

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This white paper was written in collaboration with the MassMutual Center for Behavioral Research℠. The Center is dedicated to understanding the dynamics of financial decisions and behavior in order to provide innovative retirement solutions to improve retirement outcomes.

Our highly trained team of thought leaders conducts research and analysis in collaboration with academic and industry researchers. Our insights and information are shared for the benefit of sponsors, participants and financial professionals. We experiment endlessly and fearlessly test new ideas in our efforts to help the American worker successfully retire.

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