RETIREMENT & BENEFIT PLAN SERVICES

Workplace Insights™

Bank of America Merrill Lynch

Success by plan design

Improving 401(k) plan health and employee wellness

Executive summary

For most employees, their 401(k) plan will be the sole source of retirement funding. In this paper, Bank of America Merrill Lynch highlights historically proven actions that can help improve 401(k) plan health and employee financial wellness. We also propose solutions to challenges that are preventing some sponsors from taking action.

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"In the broad evolution of benefits, one of the greatest unmet needs is in personal financial benefits, which could be pivotal in optimizing talent and innovation — especially if we can also measure financial wellness. I'm very optimistic that we are on the brink of this change. Employees are ready for it. And sponsors are, too."

— **Andy Sieg**
Head of Global Wealth & Retirement Solutions
Bank of America Merrill Lynch

"We believe that privately sponsored corporate retirement systems, particularly 401(k) plans, are successful and can be even more so. With the greater employee engagement we are seeing, and with plan and service enhancements, we can help make 401(k) plans even more vibrant."

— **Kevin Crain**
Head of Institutional Retirement & Benefit Services
Bank of America Merrill Lynch

"Most people — and the young in particular — have a tough time imagining their financial situation years from now. Yet this understanding is key to planning a successful strategy for pursuing financial wellness. Plan sponsors that are equipped with tools that help employees envision their financial future can help craft a goals-based strategy aimed at making that vision a reality."

— **Michael Liersch**
Director of Behavioral Finance
Bank of America Merrill Lynch

America's retirement plan

The 401(k) plan has never been more important — for employees or for plan sponsors. Over 50 million[1] employees in the U.S. contribute to a 401(k) plan, which for most people is their sole source of retirement funding. But research shows that employees aren't using their plans as well as they could be — about eight million employees do not participate in their 401(k) plans at all.[2] However, there is good news…

Employees and employers are ready and willing

According to the 2012 Workplace Benefits Report from Bank of America Merrill Lynch, not only are employees more aware than ever that they are responsible for funding their retirement — they also want to do something about it.

We found that 82% of employees surveyed are willing to give up a portion of their salary to secure guaranteed retirement income. But procrastination, inertia and lack of knowledge about how to take advantage of the benefits offered (and, in some cases, about plan offerings) prevent many employees from maximizing contributions and investing wisely in their 401(k) plans.

Plan sponsors are also eager to take action:

- Nearly 70% of employers surveyed feel at least somewhat responsible for helping employees understand the assets needed to sustain them later in life.
- When considering financial benefits in the workplace, employers place significant importance on a plan's usefulness to employees (88%).

Employers are rapidly seeking ways to make their 401(k) plans more effective. And they are finding that plan design can do just that. Research has shown that better outcomes can result from plan design strategies that drive such positive participant decision-making as enrolling, contributing and improving financial wellness.

We believe that, with help, employees can prepare themselves for retirement, and that it is in the best interests of sponsors to help their employees do so. What is more, we believe that long-term financial security is easier to achieve than many think. With both employers and employees in agreement that the 401(k) can and should succeed, there has been no better time for sponsors to improve the health and vibrancy of their plans.

A distinct competitive edge

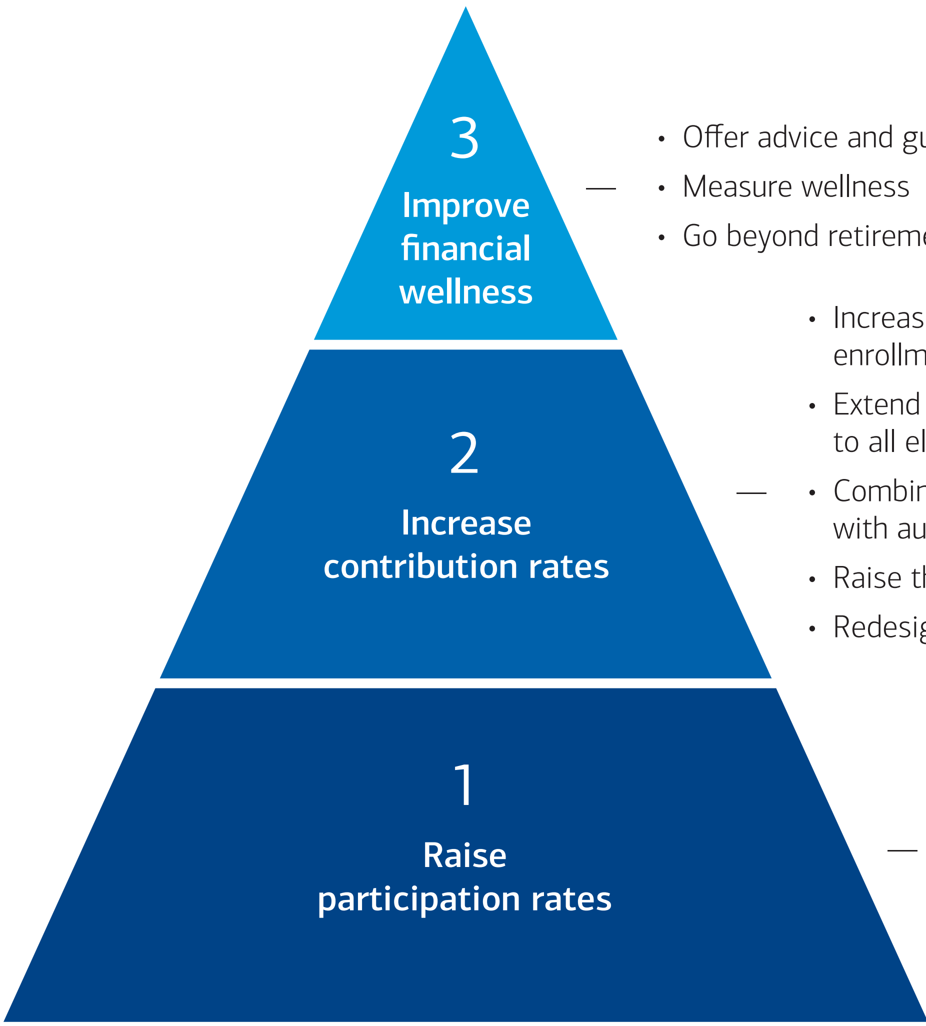
In a recent survey, 90% of employers believe that financial benefits are equally or more important to potential hires today than they were five years ago and nearly 80% of employees view these benefits as a key factor when considering or accepting a new position.[3]

In today's war for talent, a healthy, successful retirement plan has great value. We believe the best practices outlined in this paper can get plan sponsors much closer to achieving their three most critical goals:

1. ***Maximizing** employee satisfaction, awareness and productivity by providing competitive benefits*
2. ***Attracting** and **retaining** talent by rewarding your best performers, high potentials and executives*
3. ***Succeeding** by helping all employees understand their company benefits, compensation and award packages, which may, in turn, result in improved employee long-term financial security*

Action-based plan design

We've identified plan design actions that are industry best practices. All of them can be considered appropriate solutions that seek to leverage processes and products that are already available to plan sponsors. All can be employed to help improve plan health and promote employee wellness. And all can be easily implemented.



- Offer advice and guidance
- Measure wellness
- Go beyond retirement

- Increase the automatic enrollment default rate
- Extend automatic increase to all eligible employees
- Combine automatic enrollment with automatic increase
- Raise the automatic increase threshold
- Redesign the employer match

- Implement automatic enrollment
- Extend automatic enrollment to all eligible employees
- Integrate 401(k) enrollment with annual health care enrollment

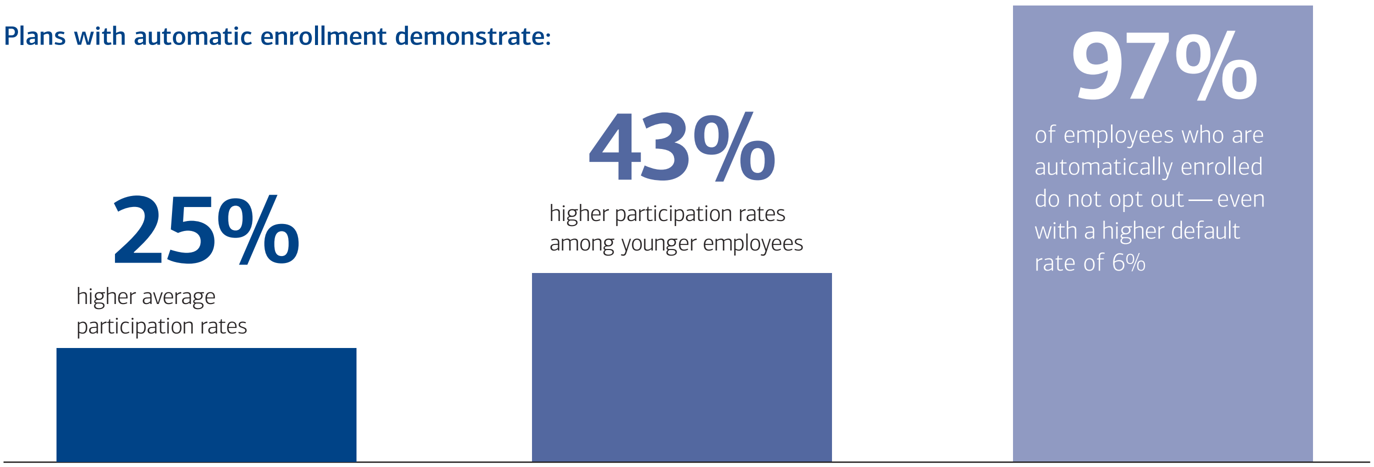
Action-based plan design

1. Raise participation rates

Implement automatic enrollment

By taking the choice out of enrolling in the plan, sponsors can easily boost participation rates, can effectively engage employees, and may even be able to keep them in the plan long-term.

Plans with automatic enrollment demonstrate:



Source: Bank of America Merrill Lynch analysis, record-kept plans, as of June 30, 2012.

Automatic enrollment is a powerful tool. Studies have shown that, if done correctly, automatic enrollment can help assure sponsors that most if not all employees will stay engaged in the plan. Notably, 85% of employees surveyed said that automatic enrollment helped them start investing earlier than they would have on their own. And even at higher default contribution rates, a high percentage of automatically enrolled participants stay in the plan (see red bar in the chart above). *"The introduction many years ago of automatic enrollment was originally met with skepticism,"* says Crain. *"But evidence is, it works exceedingly well. A very high percentage of employees enrolled automatically remain active contributors."*

Extend automatic enrollment to all eligible employees

Automatic enrollment works even better when it is extended to all eligible employees and not just offered to new hires. By ensuring that all eligible employees enroll in the plan, it assures sponsors that they are leaving no eligible employee behind.

We have seen automatic enrollment also improve overall plan wellness. Among our clients, plans with automatic enrollment have significantly higher participation rates, especially among young employees (see chart above).

Integrate 401(k) enrollment with annual health care enrollment

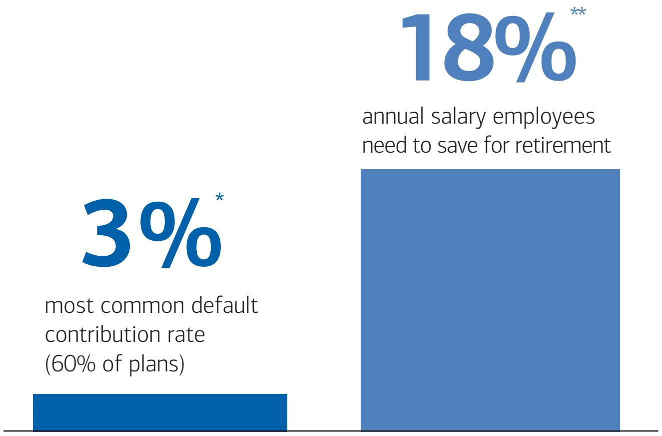
Sponsors can also boost participation rates by synchronizing 401(k) enrollment with annual health care enrollment. Associating overall health and financial wellness creates a sense of urgency on the part of employees to engage in their plan. And when sponsors make it easier for employees to enroll in the plan and raise their contribution rates, employees are more likely to take action.

Proof is in the numbers. In 2011, 90% of participants in Bank of America Merrill Lynch plans took positive action by either enrolling or increasing their contributions when health care and 401(k) events were connected.[4]

2. Increase contribution rates

Automatic enrollment gets employees in the plan. But it doesn't guarantee that employees are contributing enough for retirement. Indeed, participants who are automatically enrolled tend to remain at the default rate, which for most plans is 3%.

The average employee is not contributing enough:



Sources: *Profit Sharing Council of America (54th Annual Survey of Profit Sharing and 401(k) Plans); **The Center for Retirement Research at Boston College (How Much to Save for a Secure Retirement, November 2011).

Here are a number of actions that can help to lift contribution rates.

Increase the automatic enrollment default rate

Sponsors offering automatic enrollment can immediately improve contribution rates by setting the default rate above 3%. As we've shown, higher default rates do not cause participants to opt out of the plan (see bar chart on previous page).

Extend automatic increase to all eligible employees

The same factors that keep employees from participating in their plan often keep them from increasing their contribution rates once they are enrolled. Allowing participants to schedule gradual contribution rate increases over time makes it easier for them to commit to deferring more and helps put them on an even better retirement savings track.

Offering automatic increase is a growing trend among sponsors, who appreciate its power. Among our clients, we have seen a 23% increase in plans offering automatic increase in the past year.[5]

To understand the power of automatic increase, consider a participant who is 35 years old, earns a salary of $40,000 a year, contributes at an annual 6% rate at the beginning of each period, and opts in for a 1% yearly automatic increase to a threshold of 18%. The contributions grow at an earnings rate of 6%. After 30 years, that participant could have saved as much as $576,000, which is $330,000 more than he or she might have without automatic increase.*

*Hypothetical results are for illustrative purposes only and do not reflect actual investments made. Returns are not guaranteed and results will vary.

Combine automatic enrollment with automatic increase

We've demonstrated the effectiveness of both automatic enrollment and automatic increases. But combining the two can be more powerful than either design feature on its own.

By itself, automatic enrollment may not do enough to encourage participants to increase their contribution rates beyond the default rate. In fact, plans that combine automatic enrollment and automatic increase enjoy an average contribution rate that is double that of plans that offer automatic enrollment alone.[6]

Many participants either don't believe or have no idea whether they are on track to support their desired retirement lifestyle, according to our latest research. Combining automatic enrollment and automatic increases can be hugely effective in getting this majority of employees into the plan and contributing at rates that help get them on track for the retirement they want. It is undoubtedly one reason that we have seen a 20% increase over the past 12 months alone in the number of plans combining automatic enrollment and automatic increase.

Raise the automatic increase threshold

Automatic increase works well by taking advantage of employee inaction. The gradual increase isn't noticed, and yet participants contribute more each year.

We believe sponsors should take full advantage of this momentum — and raise the automatic increase threshold to a level that helps participants save enough. Sponsors who raise the automatic increase threshold can work with their plan providers to help ensure that costs are kept in control.

Redesign the employer match

There is a direct behavioral correlation between employer match levels and participant contribution rates. Our research corroborates what the industry has long known: Participants generally seek to maximize the employer match — contributing as much of their money as needed to get all the "free" money offered through the company match.

Sponsors can take advantage of this behavior and encourage higher contribution rates by raising the match threshold. They can also adjust the match to encourage higher contribution rates (see table below). Both techniques can entice participants to contribute more of their money. And adjusting the match can also be implemented without increasing the sponsor's matching costs.

Redesigning the match

Higher contribution rates, same costs

Match formula	Participant contribution	Employer contribution	Total contribution
100% of 3%	3%	3%	6%
50% of 6%	6%	3%	9%
25% of 12%	12%	3%	15%

*One sponsor wanting to make it easier for all participants to increase their contribution rates is **DuPont**. Many of the company's employees were already increasing their contribution rate from the 3% default rate to 6% to take advantage of the match. DuPont sought to get participants contributing beyond 6% by increasing the automatic enrollment default rate and raised the automatic increase threshold, as shown on the right:*

***Results:** A higher total contribution opportunity for participants that helps them save more for retirement. The maximum contribution, with match, went up from 15% to 24% of compensation.*

How DuPont is raising contribution rates	Old design (prior to 2012)	New design (beginning in 2012)
Automatic enrollment default contribution rate	3%	6%
Company match	100% on the first 6% of employee contribution	100% on the first 6% of employee contribution
Retirement Savings Contribution*	3%	3%
Automatic increase	Annual 1% increases up to a max. of 6%	Annual 1% increases up to a max. of 15%
Maximum contribution opportunity	15% of compensation	24% of compensation

*DuPont makes a monthly Retirement Savings Contribution of 3% of eligible pay.

3. Improve financial wellness

Financial wellness — the state of being in a good financial position — is reached by making the appropriate financial decisions, year after year. Its scope covers budgeting, home ownership, insurance, health care, college planning and retirement.

The financial wellness approach fits the way employees actually view retirement planning — as an evolving target. Says Andy Sieg, *"Our clients know that retiring isn't about their age or a magic number. They see it as an ongoing assessment of the lifestyle, goals and assets they want for their later years. For them, planning is a winding road that requires close attention and frequent course correction."*

Employees want financial wellness solutions — and plan sponsors are listening:

Sources: *2012 Workplace Benefits Report, Bank of America Merrill Lynch; **Spectrem (Retirement Market Insights, 2009); and ***2011 Quantitative Insights Report.

Offer advice and guidance

Our 2011 Workplace Benefits Report showed that 79% of employers foresee greater demand from employees for investment advice on their benefit plans. In turn, this year's study revealed that 56% of sponsors now offer access to professional advice.

We believe financial advice is a critical part of overall financial wellness. Employees want advice, they use it, and, we find, it more fully engages them with their plans. Advice Access — a Bank of America Merrill Lynch foundational offering for 401(k) clients — incorporates the key features we think any advice program must offer plan participants:

- Goals-based, easy-to-implement, individualized advice
- Unbiased third-party recommendations (in the case of Advice Access, delivered by Ibbotson Associates)
- Situational, comprehensive planning that takes all key parameters into account, from participant data and plan provisions to non-plan assets and fund restrictions
- Automatic reallocation and rebalancing, which helps ensure better investment management[7]

Measure wellness

Just as the medical field relies on measurement and diagnostics to gauge the efficacy of treatments and the wellness of individual patients, so must plan sponsors find ways to regularly measure the efficacy of their offerings and the financial wellness of their employees. Sponsors are clearly on board with measuring effectiveness: 88% of the employers we recently surveyed put great importance on their plans' usefulness to employees.

A number of robust tools are now available from most providers that measure such wellness indicators as participation and contribution rates, diversification, concentration in company stock, and plan compliance. Indicators of poor overall wellness — for example, participation rates under a benchmarked level or a projected gap in retirement savings — can point to areas for improvement at the plan level and, when appropriately shared with participants, can encourage healthier plan behavior.

For example, Bank of America Merrill Lynch's Plan in Review provides sponsors with comprehensive data on plan participation, deferral rates, investment concentration, accumulated assets, and other metrics.

We offer the Financial Wellness Monitor®, which gives sponsors a view of how well participants are using their 401(k) plans by applying a 0–10 scoring format that can be easily communicated to plan committees.

We also use the Financial Wellness Monitor to measure and communicate the effectiveness of Advice Access among our clients' plans. For more details, read our latest quarterly 401(k) Wellness Scorecard.

Go beyond retirement

Plan sponsors are well aware that their employees have financial needs beyond planning and saving for retirement. According to the 2012 Workplace Benefits Report, employee well-being has become a core value for companies. This accounts for the recent growth in flexible benefit offerings that integrate a range of financial benefits — from health care savings accounts to consumer lending — into their financial benefits platform.

Financial wellness programs often include services and offerings across the financial spectrum: general financial fitness, life transitions, money management, education and retirement planning, estate planning, eldercare, and offerings tailored to the unique needs of women.

Taking action: Easier than you think

Many sponsors are adopting these best practices and many more are considering them. What keeps some sponsors from starting is what prevents most of us from taking action — time, resources, costs, competing priorities. Here's how sponsors are solving these challenges.

Making it simpler

Employees may hesitate to enroll because they are numbed by too many choices or options. Says Michael Liersch, *"For people who face a decision, it's been demonstrated that less information and simpler choices help them take action."* And in saving for retirement, the sooner in their career that employees take action, the better prepared they will be for retirement.

Consider narrowing down the investment options. Think about automating enrollment and deferral increases. Keep decision-making simple for employees.

Changing the mindset

Many sponsors with plan health challenges have long taken a hands-off approach to their 401(k) plan, leaving it entirely up to employees to take advantage of the plan. Given the state of retirement savings, increasing demand for financial wellness solutions in the workplace, and recent advances in understanding investor behavior, we believe this is not a winning strategy.

Says Crain, *"A company culture known for making investments in their employees' financial wellness, in addition to their professional growth, can attract top talent and foster a more productive and loyal workforce that is more deeply invested in the company's success."*

Changing the company culture can take years. But a slightly dialed-up, more proactive approach can put sponsors on a path to success — something that experienced benefit service providers routinely identify and can help the sponsor implement.

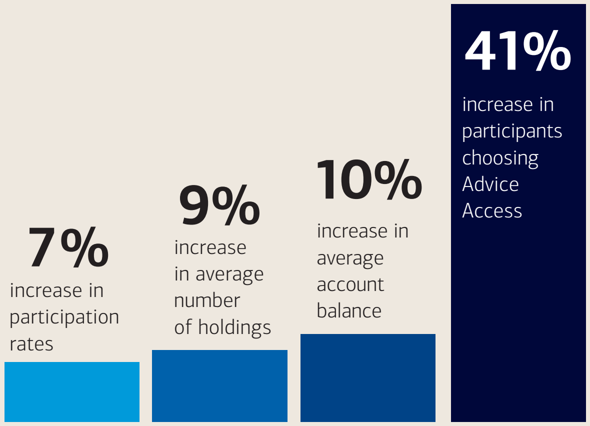
J.B. Hunt Transport Services, Inc. *has a competitive retirement plan, with matching contributions, personalized advice, and low-cost investment options. But with its large segment of truck drivers, who tend to be mobile and have high turnover, J.B. Hunt had relatively low plan participation and difficulty motivating employees to use it effectively.*

The company's data on turnover showed that employees who stayed at least six months were much more likely to remain with the company. J.B. Hunt used this key finding about their demographic to initiate a number of design changes, including:

- *a re-engineered enrollment process during new-hire orientation*
- *targeted communications to nonparticipating employees at the six-month mark*
- *re-introduction of Advice Access*
- *five new investment options*
- *employee workshops in both English and Spanish*

Results of J.B. Hunt's plan enhancements

A healthier plan: Higher participation, contributions, diversification and advice utilization.



Plan design results from January 2011 to March 2012.

Working around difficult demographics

Workforce demographics can often be addressed by plan design tactics. For example, companies with high employee turnover may be able to improve plan health by delaying automatic enrollment for six months to a year.

Finding cost-aware solutions

Plan sponsors are justifiably concerned about costs. But the costs of many plan design changes, including these best practices, are more modest than most sponsors may think.

For example, the average nonparticipating employee has a modest salary, and therefore the cost of that employee's match will also be modest. Moreover, the match is tax-deductible for the sponsor.

An experienced benefit plan provider can help identify cost-agnostic solutions — the classic case being tiered match levels to reduce or nullify the cost of automatic enrollment.

Communicating more effectively

Consistent communication and education are critical to plan effectiveness. Of the 30% of employees who don't feel they are taking full advantage of the financial benefits offered to them, 35% said they don't know how to take advantage of what's available, according to our 2012 Workplace Benefits Report. We believe better, more personalized, more targeted communications and education provide sponsors with an opportunity to significantly improve employee satisfaction with retirement benefits.

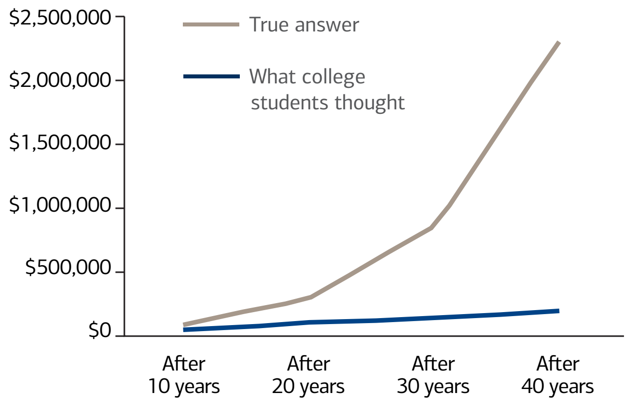
Ongoing outreach on the importance of saving for retirement has historically driven employee action, particularly when tailored to age and life stages and when reinforced through multiple touch points.

Milestones such as annual salary increases and bonus periods are additional opportunities to restate the benefits of contributing to 401(k) accounts and to remind employees that they can go beyond default deferral and increase rates.

The best communications programs incorporate advances in behavioral finance to connect with particularly hard-to-reach employee segments and explain abstract concepts. Liersch cites the difficulty younger employees have in understanding the power of compounding.

Young employees need better communication

How young people think $400 invested every month at a 10% annual rate of return will grow over time, relative to how the investments would actually grow.



This chart is a hypothetical example meant for illustrative purposes only.
Source: McKenzie and Liersch, 2011.

Many people think that money increases in straight lines, growing in value at the same rate over identical time periods. The group shown in the chart above vastly underestimates the ending wealth of small sums saved monthly. In reality, however, due to the power of compounding, money can grow exponentially.

Scientific evidence suggests that calculating compound interest is a challenge for the human mind.[8] And imagine how much more difficult it is to project future money growth as complexity increases — for example, when rates of return change over time — because instead of one, there are many possible outcomes. The best way to overcome this challenge and motivate younger employees entering the workforce to save, suggests Liersch, is to regularly show them their potential 401(k) account balances at retirement.

Taking your next steps

Implementing plan design changes involves preparation, education and advocacy — not to mention paperwork. These extra steps may keep some sponsors from making necessary changes. But help is available.

Work with a benefit provider that has the expertise to help you start the process and keep it moving. Presenting to the committee, explaining new design features, putting together employee communications, and even helping with documentation are all part of what a proactive provider will help you accomplish.

"Our country's retirement system is facing a great deal of scrutiny," Crain adds. *"We all need to work together to continuously improve the health and vibrancy of this system — and the financial lives of the people participating in it."*

*To find out more about these best practices and how you might implement them, contact your Bank of America Merrill Lynch representative or call **1.877.902.8730**. You can also visit us online at **benefitplans.baml.com** or email us at **benefitplans@baml.com**.*

[1] ICI Research Perspective, December 2011, Investment Company Institute.

[2] Deloitte 401(k) Benchmarking Study, 2009.

[3] Bank of America Merrill Lynch, 2012 Workplace Benefits Report. Methodology: Boston Research Group interviewed a national sample of 1,000 employers of all sizes and 1,000 employees from January 2012 through March 2012 on behalf of Bank of America Merrill Lynch. To have qualified for the survey, employers must have offered their employees a 401(k) plan.

[4] Represents three institutional plan sponsor clients that have integrated retirement plan enrollment with healthcare enrollment (2009-2011).

[5] Bank of America Merrill Lynch analysis, record-kept plans, as of June 30, 2012.

[6] Source: Bank of America Merrill Lynch analysis, record-kept plans, as of June 30, 2012.

[7] Asset allocation, diversification and rebalancing do not ensure a profit or protect against loss in declining markets.

[8] Eric Eisenstein and Stephen Hoch, "Intuitive Compounding: Framing Temporal Perspective, and Expertise," working paper, Johnson School of Management, Cornell University.

The Advice Access service uses a probabilistic approach to determine the likelihood that participants in the service may be able to achieve their stated goals and/or to identify a range of potential wealth outcomes that could be realized. Additionally, the recommendations provided by Advice Access do not consider an individual's comfort level with investment risk, and may include a higher level of investment risk than a participant may be personally comfortable with. Participants are strongly advised to consider their personal goals, overall risk tolerance and retirement horizon before accepting any recommendations made by Advice Access. Participants should carefully review the explanation of the methodology used, including key assumptions and limitations, which is provided in the Advice Access disclosure statement. It can be obtained through Benefits OnLine or through your Bank of America Merrill Lynch representative.

IMPORTANT:** **The projections or other information shown in the Advice Access service regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. Results may vary with each use and over time.

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