ADMINISTRATION

Re-enrollment: Getting Participants on the Right Track

Re-enrollment offers the most appealing combination of potential advantages to both plan sponsors and participants.

BY CATHERINE PETERSON

Plan sponsors continue to seek ways to simplify the investment decisions of their participants and improve the manner in which investments are allocated. While putting new employees on the right path to retirement success can be accomplished relatively easily through automatic enrollment, plan sponsors face a unique challenge in motivating existing participants to make changes to their investment options that may be highly beneficial for them in the long run.

Though many plan sponsors have engaged in robust participant education efforts, inertia has persisted and there is a general lack of confidence that participants are appropriately diversified within their 401(k) portfolios. As Fig. 1 illustrates, only about one-third of plan sponsors are highly confident that the majority of participants has an appropriate asset allocation. Plan participants themselves are even less confident, with only 25% of them highly confident in their ability to appropriately allocate their savings across available options.

Plan sponsors have sought to address this issue by incorporating target date funds into their investment menus. These vehicles, which provide age-appropriate diversification, can potentially provide participants and plan sponsors alike a greater comfort level with how assets are allocated.

EVALUATING OPTIONS THAT CAN HELP SIMPLIFY PARTICIPANT ASSET ALLOCATION DECISIONS

Generally speaking, there are three basic approaches plan sponsors can use to increase participant adoption of TDFs, which are usually the QDIA of choice.

- **Add-to-the-menu:** Add TDFs to a plan's investment lineup and allow participants to choose for themselves.

- **Investment re-set:** Transfer, or "map," participants' existing assets and subsequent contributions into TDFs and allow changes only after the transfer has taken place.
- **Re-enrollment:** Move participants' existing assets and subsequent contributions to the age-appropriate TDF. As a result, assets are automatically moved on a certain date unless the participant opts out or makes a different investment election before the designated deadline.

A plan re-enrollment is a process by which participants are notified that their existing assets and future contributions will be invested in a plan's QDIA (typically a target date fund), based on their date of birth. All plan participants are automatically moved into the QDIA on a certain date unless they opt out or make a new investment election during a specified time period.

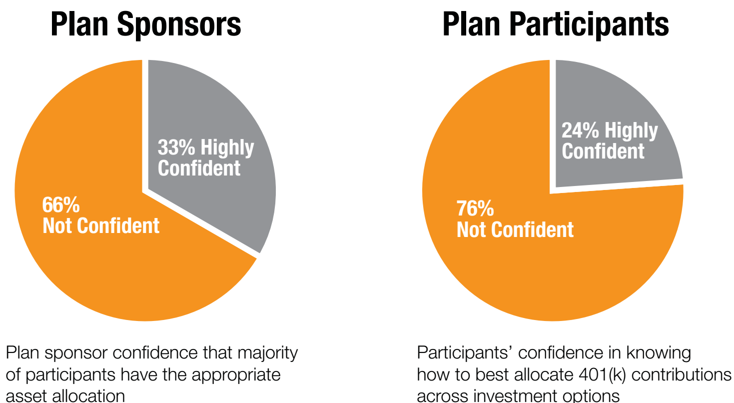
In the past, many plan sponsors selected the add-to-the-menu strategy because they believed participants should decide on their own how to invest their savings. This approach has left many plan sponsors disappointed with the results. Based on J.P. Morgan's research, the typical adoption rate for adding TDFs to the menu is only 1% to 5%.

Alternatively, plan sponsors that choose to directly reset employees into a TDF typically enjoy substantially greater adoption rates of 80% to 90%. But one major drawback to this process has been that a reset does not provide safe-harbor protection to the plan sponsor since the participant was not given the option to opt out or make a new investment election before the assets were moved.

UNDERSTANDING THE BENEFITS OF RE-ENROLLMENT

Of the primary options available to plan sponsors seeking to increase the use of TDFs by participants, a plan re-enrollment offers the most appealing combination of potential advantages to both plan sponsors and participants.

FIG. 1: LACK OF CONFIDENCE IN PARTICIPANTS' ABILITY TO ALLOCATE



Plan sponsor confidence that majority of participants have the appropriate asset allocation

Participants' confidence in knowing how to best allocate 401(k) contributions across investment options

Note: Total n = 1,009. Totals may not equal 100% due to rounding.
Source: J.P. Morgan Plan Sponsor Research 2013

Note: Total n = 796.
Source: J.P. Morgan Plan Participant Research 2013

Allocation and Diversification

A re-enrollment helps to overcome participant inertia by helping those investors who may benefit from professional management and defaulting their savings into age-appropriate portfolios (while still giving other more sophisticated and active participants the opportunity to make their own investment decisions). At the same time, it provides plan sponsors with greater confidence that participants' assets will be more appropriately diversified within their 401(k) plans.

Implementation Strategy

It's not enough for plan sponsors to simply add a suite of TDFs to their plan and expect participants to allocate funds to these options. Instead, plan sponsors need to execute an implementation strategy that encourages greater usage of the TDF.

Research has shown that implementing a re-enrollment strategy can have a dramatic impact on improving the overall asset allocation of many participants in a short period of time. For instance, J.P. Morgan research shows that many plan sponsors who conduct a re-enrollment see significant TDF adoption rates, regardless of the type and size of the plan (see case study below).

A re-enrollment can be implemented regardless of whether a plan sponsor is converting to a new record keeper or staying with its current one. Plan sponsors can also use the strategy when making changes to the plan's investment menu or simply as a way of encouraging shifts in investment allocation.

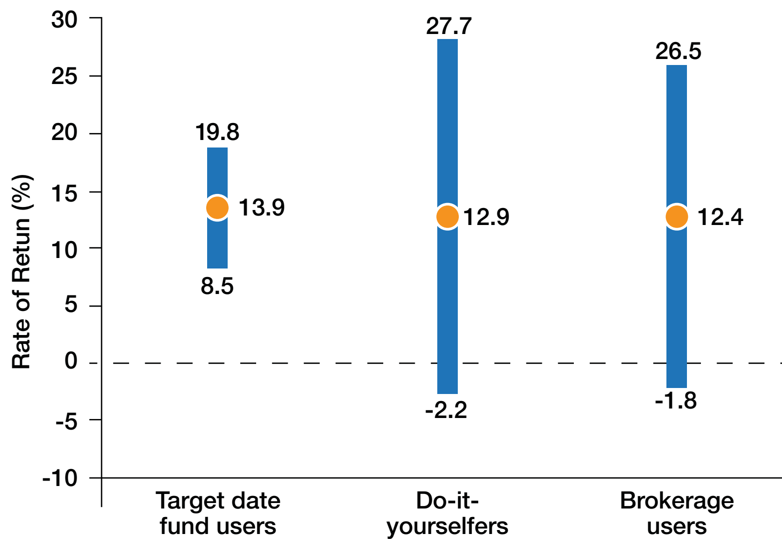
Defining Re-enrollment

A plan re-enrollment is a process by which participants are notified that their existing assets and future contributions will be invested in a plan's QDIA (typically a target date fund), based on their date of birth. All plan participants are automatically moved into the QDIA on a certain date unless they opt out or make a new investment election during a specified time period.

Safe-harbor Protection

Regardless of when it is

FIG. 2: STANDARDIZED 5-YEAR RETURNS — HIGHS, LOWS AND MEDIANS BY INVESTMENT STRATEGY



Source: J.P. Morgan Retirement Plan Services proprietary research. Analysis measurement period is December 31, 2008, through December 31, 2013. The above data represents a sampling of participant data. It does not represent the returns of any individual product or portfolio. Exclusive reliance on the above is not advised. This information is not intended as a recommendation to invest in any particular manner. Rate of return for the measurement period is aggregated by investment strategy. Historical rate of return is not a guarantee of and may not be indicative of future results. See the "Important Disclosures for Personal Rate of Return Methodology," for additional information.

Fiduciary Considerations

As a fiduciary, plan sponsors may qualify for QDIA safe-harbor protection by satisfying two requirements:

- Initial opt-out notification: Participants must be given the opportunity to make a new investment election before being defaulted into the plan's QDIA. This initial notice must be provided at least 30 days before the beginning of the re-enrollment window to satisfy the legal requirement. Although not required, reminder notices are often sent before the end of the re-enrollment period to ensure no participant is inadvertently defaulted.
- Annual notices. Annual notices must be provided to participants to remind them that they were defaulted into QDIA and they have the right to direct the investments in their accounts.

conducted, a re-enrollment can offer safe-harbor protection to plan sponsors for the assets that are defaulted into a QDIA. Though re-enrollment has been used successfully by many plan sponsors, many other plan sponsors are either unaware of its availability or unfamiliar with the potential benefits. In fact, J.P. Morgan's plan sponsor research revealed that 56% of plan sponsors are not aware they would receive fiduciary protection for participant assets defaulted into a plan's QDIA during a re-enrollment (see "Fiduciary Considerations" sidebar).

MAKING A DIFFERENCE WITH RE-ENROLLMENT

Re-enrolling participants into investment options such as TDFs, which provide professional management and increasingly conservative risk/return profiles as retirement approaches, can not only help improve asset allocation, but also maintain an appropriate allocation over time. These options also help minimize extreme outcomes by providing participants with a more consistent investment experience than the portfolios individually constructed by most "do-it-yourselfers" or brokerage users (see Fig. 2).

Plan sponsors that have not yet conducted a re-enrollment may want to consider this strategy for improving their participants' asset allocation. Ultimately, a re-enrollment can offer sponsors a dual reward: the opportunity to benefit from safe harbor fiduciary protection, while providing a well-diversified investment experience for participants seeking a secure retirement.

CASE STUDY

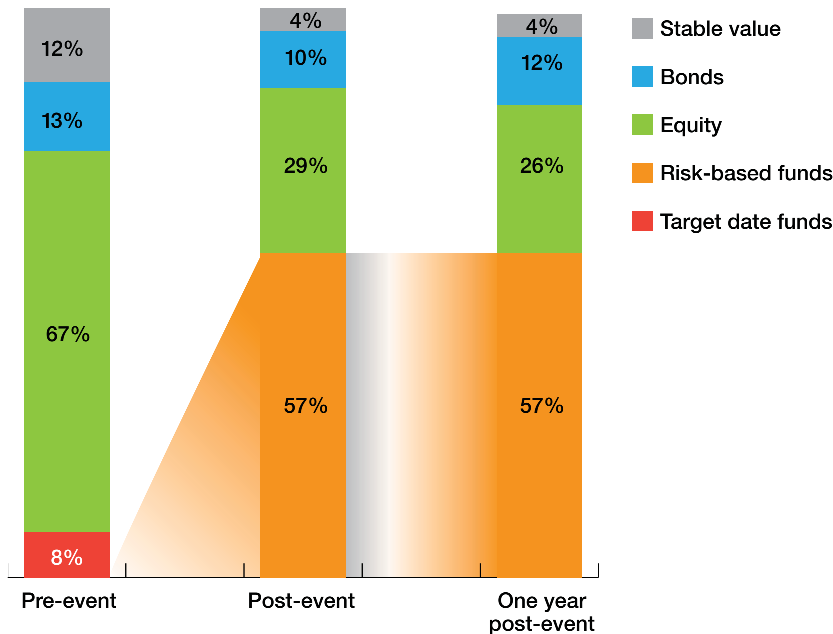
Consider the experience of one plan sponsor with roughly 1,650 participants and more than $60 million in assets. The sponsor was concerned its participants were making poor asset allocation decisions that would diminish the investment results of their retirement accounts.

After careful analysis, the plan sponsor decided to:

- Introduce target date funds (TDFs) as part of its investment lineup as one way participants could more appropriately diversify how they were investing their retirement funds.
- Conduct a re-enrollment in which participants who failed to make investment elections would be defaulted (unless they opted out) into an age-appropriate TDF designated as the plan's Qualified Default Investment Alternative (QDIA).
- Execute a multi-channel communications strategy to clearly outline the re-enrollment process, how it will affect participants, and any actions they need to take.

As the exhibit below illustrates, prior to the availability of TDFs, roughly two-thirds of the plan's assets were invested in equities. Following re-enrollment, however, 57% of the plan's assets (representing 63% of participants) were invested in an appropriate TDF based on the

FIG. 3: RE-ENROLLMENT CASE STUDY: A DRAMATIC SHIFT IN ASSET ALLOCATION



Source: J.P. Morgan Retirement Plan Services, December 2013

participants' ages. After the process was complete, the plan sponsor received very positive feedback, with relatively few participants — only 2% — raising questions about the re-enrollment.

One year after completing the re-enrollment, 57% of the plan's assets (now representing 61% of participants) remain invested in TDFs, and both the plan sponsor and its participants continue to reap important benefits:

- In addition to continuing to offering a wider range of investment choices to participants, the plan sponsor is receiving safe-harbor protection for the defaulted assets.
- Many participants are continuing to invest in professionally managed and broadly diversified investments that offer the potential for improving their chances of replacing more of their income at retirement. PC

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Target date fund users are participants with at least 70% of their account balance invested in target date funds as of the first and last day of the measurement period. Do-it-yourselfers are participants with less than 70% of their account balance invested in target date funds as of the first and last day of the measurement period and also includes participants using online advice services, if applicable. Managed account users are participants with at least 70% of their account balance managed by a discretionary investment service as of the first and last day of the measurement period. Brokerage users are participants with at least $1 in a brokerage account as of the last day of the measurement period.

TARGET DATE FUNDS. Target date funds are funds with the target date being the approximate date when investors plan to start withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative as the fund nears the target retirement date. The principal value of the fund(s) is not guaranteed at any time, including at the target date.

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