

A Participant-Centric Approach

Everybody Wins

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Defined contribution plans have eclipsed the traditional pension plan as the key retirement savings vehicle for American workers. As of the end of 2005, according to the Investment Company Institute, approximately 47 million participants have invested \$1.78 trillion in their employer-sponsored retirement plans.¹ But are most participants equipped to know and understand how to invest that \$1.78 trillion? Armed with limited education and experience, have they formulated realistic retirement income goals? And, are they confident that their savings will fund their retirement income goals?

It has become clear that the answer to each of these questions is “no!”

What is needed is a fundamentally different approach. Retirement income security in defined contribution plans can only be achieved through an approach that targets distinct types of investors. Each type requires different tactical solutions. Retirement plan providers and plan sponsors should consider the needs of each group separately in the context of a unified, yet flexible, savings and investment program. And, when considering the needs of the group as a whole, it is imperative to recognize that all participants need continuous feedback on their progress toward meeting their retirement goals.

TAKING STOCK: SO, HOW ARE WE DOING?

Given the enormous growth of the defined contribution plan industry, has it really been successful? Employers have doubts.

Aon Consulting's 2006 *National Employee Benefits Trend Survey* found that 39 percent of employers believe that only half of their employees will have enough income to retire at a reasonable age (ages 62 to 65).

Increasingly, employers are looking to their plan providers for a better solution. According to a 2006 study by Brightwork Partners, LLC, the most cited reason for plan sponsors switching providers was: “we wanted better investment advice for our participants.” The 4th most cited reason was “we wanted better participant education materials.” And ranking 5th was “we wanted a provider that could help us achieve higher participation and deferral rates.”

THE PARTICIPANT EXPERIENCE GIVES US THE ULTIMATE ANSWER

The best way to gauge the success of the defined contribution plan is to look at the ultimate end-user: the retirement plan participant. There is no shortage of industry data that speaks to the failure of retirement planning in America so far:

- Nearly one in four Americans, or 23 percent, has not yet begun to save for retirement.²
- 75 percent of workers have less than \$10,000 saved for retirement.³
- More than half of workers age 55 or older have less than \$50,000 saved for retirement.³
- 73 percent of plan participants say they aren't overly confident in their investing abilities.⁴
- One in five Americans think the most practical way to accumulate wealth is by winning the lottery, not saving or investing.⁵

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- Almost half of consumers say retirement planning is harder than raising a child.⁶
- Nearly three out of five Americans ages 35 to 49 are saving less than \$10,000 a year. Nearly a third of Americans saved nothing for retirement in 2005.⁷
- 22 percent of baby boomers say they'll rely on the sale of their home for income in retirement.⁸
- Almost half of Americans – 46 percent – expect to fund their retirement through Social Security and pensions, and an equal number expect that their retirement funds will last them 10 to 20 years.⁹

BACK TO THE FUTURE

Despite the established history, popularity and growth of employer-sponsored defined contribution plans, it is all too clear that the industry still does not have the right combination of solutions in place for plan participants or employers.

To better understand what the industry needs to do now, we must first look to the past.

The first approach, in the early eighties, was a basic package of enrollment materials – ranging from retirement planning and investment planning workbooks, slide savings calculators, enrollment videos and other ancillary tools. Materials were sometimes supported by an onsite enrollment meeting (which may or may not have been mandatory) given by a representative of the company's retirement plan provider. That person stood at the front of the room, with a projector and slide show presentation, and methodically ticked off all the reasons we needed to save, and why the 401(k) plan was the perfect way to do it.

This approach exists to a significant degree, even today. However, most industry professionals would agree that simply giving 401(k) and other defined contribution account participants passive advice and education such as this, with the expectation they will prudently manage their own retirement accounts, has failed. Government and retirement plan providers have been left to look for alternative solutions that will work.

In 2001, the Department of Labor issued what is known as the “Sun America Opinion.” The opinion essentially helped create professionally managed 401(k) accounts, and was the first attempt at giving more active support to plan participants. Online advice providers arrived on the scene, and invested millions of dollars in technology to deliver complex, computer-modeled advice via the Internet (such as Monte Carlo simulations and the like). Over the next several years, the advice vendors worked at improving the participant experience in order to drive up adoption rates. However, despite the significant financial and human capital investment, a relatively small number of plan participants – less than 20 percent - are using these services today.

WHERE DID WE GO WRONG?

Why have previous efforts by the industry failed to engage participants to any significant degree? The efforts have failed, in part, because they do not recognize individuality. The “one size fits all” approach to participant education has simply not been effective. In addition, despite the money and manpower invested in delivering retirement planning, education and advice either in print or electronically, most retirement plan participants remain uncomfortable and ill-prepared to make investment and savings decisions. They desire proactive communications, human contact, and a personal annual review to assure that they are on track in meeting their personal retirement income goals.

In support of this point, a 2006 Scarborough Group survey found that 72 percent of participants would prefer to use personal management for their 401(k) plan (meaning an advisor provides personal investment advice and also manages their account assets). Only 20 percent of participants said they

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would prefer an internet-based form of advice, and only 4 percent of participants said they would trust advice generated from an internet-based application, down from 5 percent in 2001.¹⁰

Because each participant has a unique background and set of circumstances, a more personal and individualized approach can be much more valuable. Simply delivering a computer model and calling it a managed retirement account solution may help performance to some degree, but may not meet the diverse needs of each investor as they set their long term goals for retirement. Instead of cookie cutter solutions, the industry must evolve toward a customized approach for all types of investors.

A PARTICIPANT-CENTRIC APPROACH IS NEEDED

In August of 2006, President George W. Bush signed the Pension Protection Act (PPA). The PPA of 2006 encourages employers to take a more active role in their employees' retirement plans by offering investment advice and automatic enrollment tools designed to help people save. Prior to the Act, many companies shied away from such direct involvement in their employees' financial future due to the fear of lawsuits should their plan investments fail to perform adequately.

The PPA opens the door to new methods. What is needed is a fundamentally different approach. Retirement income security in defined contribution plans can only be achieved through an approach that targets distinct types of investors. Each requires different tactical solutions. Retirement plan providers and plan sponsors should consider the needs of each group separately in the context of a unified yet flexible savings and investment program. And, when considering the needs of the group as a whole, it is imperative to recognize that all participants need continuous feedback on their progress toward meeting their retirement goals.

REDEFINING THE PARTICIPANT

Generally speaking, there are three groups of plan participants and each group needs to be addressed in a different way:

- **Those who want to build their own retirement and investment plan (the “do it myself,” or “self-guided” individual).** This participant group is independent and self-assured about the market and investing. While retirement planning tools and education are made available to them by their employers or plan providers, in most cases they choose not to use them. Their needs are simple – they want high-quality investment options, or access to a self-directed brokerage account window. Generally speaking, this group is relatively small – perhaps 10 percent of all retirement plan participants fall in this category.
- **Those who want assistance and/or guidance in the form of some investment education and interactive tools (the “help me do it” individual).** This participant group wants to retain some independence in the planning process, but needs help getting started. In addition, they would like some guidance to help them maintain their portfolios over time. Depending on the industry, and participant demographics, this group typically is another 30 – 40 percent of the employee population.
- **Those who want advice or professional management of their account (the “do it for me” individual).** This participant group can be convinced that savings and retirement planning is important and necessary. However, they lack the knowledge, time and/or discipline to manage the process. Depending on the industry, and participant make-up, this group is typically 50 percent or more of the employee population.

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As a side note, the industry seems to be responding to the needs of this group. According to the Profit Sharing Council of America's 49th Survey of Profit Sharing and 401(k) plans, almost half of all 401(k) plans now offer a participant advice service.

While the characteristics of each group are distinctly different, there is one common denominator: once a retirement plan is in place, every participant needs continuous feedback along the way. They need to understand what progress is being made.

A successful retirement plan, at its core, needs to be goal-based. It starts with a determination of retirement income needs based on an individual's unique vision of their life in retirement. There are really only two basic questions that a participant wants answers at any given point in time: at the rate I am saving, will I have enough money at retirement to fund my vision? If at a certain point in time, there is a projected income shortfall, what tactical solutions do I need to implement to get me back on track?

THE STANDARD SOLUTION AS A MODEL

The Standard's participant-centric solution addresses the unique needs of the three groups of participants. In addition, our solution includes a goal-based approach for each participant, regardless of which group they are in. Specifically, a gap analysis report is prepared for all participants that shows them immediately whether or not they are on track to meet their stated retirement income goals -- or are projected to have a shortfall. In the case of a projected shortfall, the gap analysis includes tactical solutions for "closing the gap," such as increasing their contribution or revisiting their asset allocation strategy.

1. The Standard's "do it myself" (self-guided) solution.

These participants want to actively maintain their investment strategy and portfolio themselves. The Standard makes it easy for them to revise their investment plan along the way, by providing them with retirement and investment planning tools; however, few true "do it myself" participants will utilize them.

The Standard solution allows this participant group to build their own portfolios in an open-architecture environment. They select from a list of individual, non-proprietary funds approved through our strict due diligence and investment selection screening process. This group may also select, if they so desire, a pre-allocated portfolio comprised of these same funds. Alternatively, participants may choose to invest through a self-directed brokerage window if it is made available to them through their plan.

2. The Standard's "help me do it" solution.

The Standard solution makes retirement and investment planning tools available to this group. Most of these participants will utilize these tools to validate their thinking process and decisions, while maintaining control. The tools provide suggestions, but the participant must "push the button".

Participants in this group tend to choose a pre-allocated portfolio versus building their portfolio from a list of individual funds. Utilizing easy-to-use tools to assess their risk and time-based needs, participants will select a pre-allocated portfolio made up of non-proprietary funds approved through our strict due diligence and investment selection screening process. Although participants can choose to have their portfolios automatically rebalanced to maintain their chosen investment strategies, they are responsible for monitoring their asset allocations and contribution levels and making the appropriate changes to either or both as they deem necessary.

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3. The Standard's "do it for me" solution.

For those plan participants who do not have the time, knowledge and/or discipline to manage their retirement savings, there is a better solution. They can choose to delegate the active and ongoing management of their accounts to The Standard, a registered investment advisor. The Standard solution goes beyond the traditional managed account/advice solution that is prevalent in the industry today. It is not just an investment solution. It is a formal, goal-based savings and investment plan which is implemented and actively managed by The Standard.

The process of building a customized plan begins with the information included in the initial gap analysis report. Outside assets, as well as spouse/partner assets, are also included. From this information, a formal savings and investment plan is produced that focuses on achieving the participant's projected retirement income needs. The Standard solution looks at each participant's unique situation and determines an optimal course for the dependent variables of savings rate and asset allocation. Assets are invested among a series of broadly diversified, institutionally-priced portfolios.

Once a participant's savings and investment plan is implemented, the account is reviewed on a quarterly basis. Rebalancing or re-allocations are performed as necessary. Participants receive a progress report each quarter which illustrates progress made toward reaching their goals. In the case of a projected retirement income shortfall, tactical solutions are implemented (such as increasing the savings rate or revising the asset allocation strategy).

The Standard solution remains actively managed, and assumes that a participant's personal situation will change and evolve over time. As changes occur, the participant can call a registered investment adviser representative and have the savings and investment plan updated immediately. For example, a change in marital status usually requires an immediate update of the plan. Changes in a participant's tolerance for risk over time can be incorporated into the plan as well. This asset allocation flexibility is far superior to an age-targeted or time-based portfolio approach. Such solutions only incorporate an initial snapshot of risk tolerance, and are not personalized to an individual's unique needs.

The popularity of The Standard managed account solution is reflected in a participant adoption rate significantly higher than the current industry figures for other managed account programs – nearly 60%. This rate has held steady for over 2 years. In fact, participants in this group are willing to pay a nominal fee for this service.

A PARTICIPANT-CENTRIC APPROACH: EVERYBODY WINS

How do all parties in the channel benefit from a participant-centric approach?

Plan Provider and Plan Advisor

Providers and advisors who help participants meet their retirement income needs will be highly sought-after by plan sponsors. According to the 2006 Boston Research Group DCP Survey of plan sponsors, almost all non-human touch services such as recordkeeping and Web sites have been almost completely commoditized; levels of satisfaction for everything *except* employee education and investment performance are at all-time highs.

To become market leaders, providers and advisors must make it a top priority to focus on a participant-centric approach to retirement planning.

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Plan Sponsor

A highly effective retirement benefit program will help employers retain quality employees and recruit others. This is especially valuable in competitive labor markets where smaller employers may not be able to compete with larger companies offering higher wages. In addition, any benefit program that improves employee financial wellness may also help increase productivity. The 2001 National Report on Work & Family showed that improving employee financial wellness resulted in a 40 percent boost to company financial performance.

Integrating a participant-centric approach in a retirement benefit program positions the plan sponsor as an employer who truly understands the importance of giving employees an adequate retirement. It positions an employer as one who understands that each individual is different and requires a customized solution. It positions the employer as one who wants to do the right thing for their employees.

Here are the keys to making the retirement benefit program successful for employees:

- Education alone will not work. Adopt a solution that addresses the needs of the three distinct groups of employees. Each group requires a unique retirement planning solution. The solution absolutely must include ongoing feedback to help gauge progress toward meeting retirement goals.
- The initial enrollment meeting is just the start. Endeavor to make your enrollment meetings mandatory. If you are unable to make enrollment meetings mandatory, conduct a campaign to get people in the seats, and consider motivators such as a raffle or door prizes.
- Think about using an alternative term for the enrollment meeting. A campaign leading up to the meeting that says “invest in your future” (rather than “come to the enrollment meeting”) can make it sound fun and enlightening rather than a painful experience.
- Make retirement planning part of your company culture. A key component of that approach is treating your retirement plan benefit program as an ongoing advertising and public relations campaign. Keep the features and benefits of your plan in front of your participants, utilizing all communication channels available (Web, newsletter, posters, payroll stuffers, emails, and the like). Keep your messaging positive, inspirational and actionable.

CONCLUSION

When it comes to retirement planning in the United States, there is still time to get it right. But each party to the process must understand their role in making it successful. The plan provider, the plan advisor, and the plan sponsor must all take responsibility. Each party must avoid the mistakes of the past.

As always, the industry will need to look for validation from the end-user: the plan participant. The leaders in this process will be those that recognize that a participant-centric approach – one that acknowledges that not all participants are alike – is the key. And understanding the common denominator for all participants – the need for continuous feedback on progress toward achieving retirement goals - is the foundation of success.

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END NOTES

¹ Figures are as of year-end 2005 and include 401(k) plans, 403(b) plans, 457 plans, Keoghs, and other defined contribution plans without 401(k) features.

² 2006 Harris Interactive Poll for the American Institute of Certified Public Accountants, as reported on www.retirementsmarts.org.

³ Employee Benefit Research Institute's *2006 Retirement Confidence Study*, in partnership with Matthew Greenwald and Associates.

⁴ The Scarborough Group 2006 survey, as cited by Rebecca Moore in her article "Participants Not Confident in Investing Abilities;" *PlanSponsor*, Nov. 28, 2006.

⁵ 2005 Consumer Federation of America, as reported on www.retirementsmarts.org.

⁶ 2006 ING survey, as reported on www.retirementsmarts.org.

⁷ 2006 Financial Services Forum Survey, as reported on www.retirementsmarts.org.

⁸ 2006 Fidelity Survey, as reported on www.retirementsmarts.org.

⁹ 2006 Harris Interactive Poll for the American Institute of Certified Public Accountants, as reported on www.retirementsmarts.org.

¹⁰ Rebecca Moore, "Participants Not Confident in Investing Abilities" (*PLANSponsor* Magazine, Nov. 28, 2006).

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