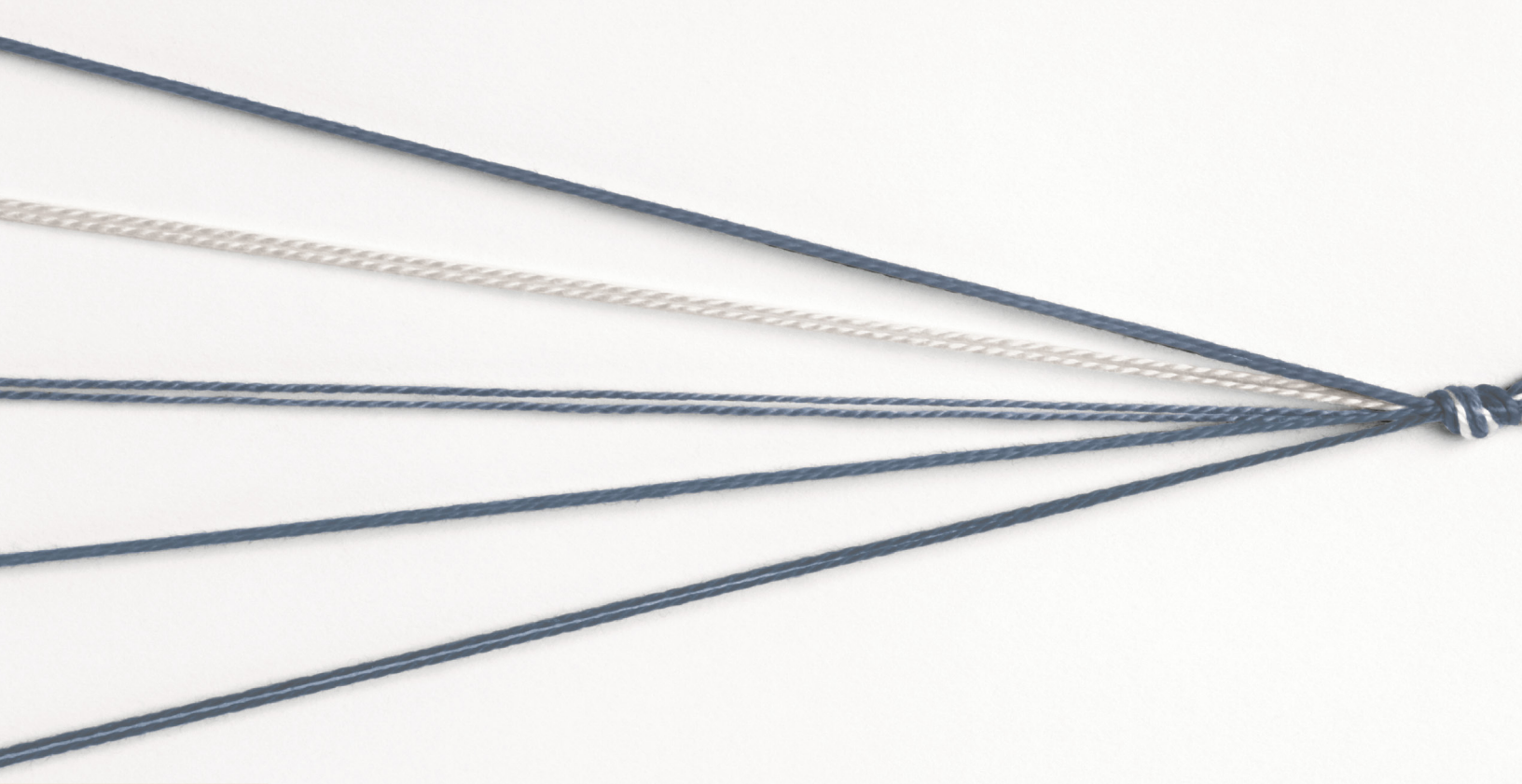


RETIREMENT INSIGHTS

2013 Defined Contribution Plan Sponsor Survey Findings

Evolving toward greater retirement security

J.P.Morgan
Asset Management

METHODOLOGY AND RESPONDENT PROFILE

To gain a better understanding of the goals and motivations as well as actions and reactions of employers in shaping the continuing evolution of their defined contribution (DC) plans, we partnered with Mathew Greenwald & Associates, a market-research firm based in Washington, D.C., to conduct an online survey of 796 plan sponsors from December 18, 2012, through January 25, 2013. Each respondent was a key decision-maker with respect to the organization's DC plan. All companies represented have been in business for at least three years, offer a 401(k) or 403(b) plan to their U.S. employees and have at least 10 full-time employees.

Below are breakdowns of our sample of plan sponsors both by plan assets and by organizational role. Results aggregated across plan size categories were weighted to reflect the size distribution of plans in the U.S. DC plan universe.

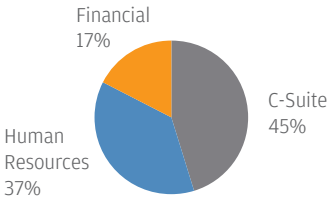
RESPONDENT DISTRIBUTION BY TOTAL DC PLAN ASSETS*

Less than $1 million	201	
$1 million to just under $10 million	205	
$10 million to just under $50 million	150	
$50 million to just under $250 million	115	
$250 million to just under $1 billion	75	125
$1 billion or more	50	

*Total number of respondents (n) = 796.

Source: J.P. Morgan DC Plan Sponsor Research 2013.

RESPONDENT COMPOSITION BY ORGANIZATIONAL ROLE (% OF TOTAL**)



Note: Totals may not equal 100% due to rounding.

**Organizational role definitions: "C-Suite" is owner/partner, chairman, president, CEO, executive director or other general senior management position; "Human Resources" is human resources or employee benefits; "Financial" is CFO, chief investment officer or other financial, investment or treasury position.

In this paper you will see direct quotes from survey respondents to the following question:
"If you could do it all over again, what would you change about the structure of your company's retirement plan?"

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Executive Summary

Overview

Our inaugural *Defined Contribution Plan Sponsor Survey* canvassed 796 senior plan decision-makers to gain perspective on how they and their organizations are responding to the increasingly vital role of DC plans in assuring employees' retirement security.

Over the course of its first 30 years, the DC plan has steadily become a major contributor to the financial security and well-being of many Americans in retirement. The transformation of these plans, from a supplementary benefit to a stronghold for retirement security, has required significant adaptation and change—in vision and action—from all constituents:

- Participants, required to take on greater responsibility for saving an adequate amount and making informed investment decisions, continue to feel overwhelmed by the task and admit that they want and need professional support.
- Plan sponsors are adapting to these changes and are taking important steps to shape the evolution of DC plans to help ensure a secure retirement for their employees.
- Providers, advisors and consultants are working with plan sponsors to provide cost-efficient administration, effective communications, thoughtful investment options and strategic guidance on opportunities to strengthen DC plan design.
- Policymakers and regulators, cognizant of the dominant share of retirement income these employer-sponsored plans are expected to provide, have taken concerted action to encourage participant savings and support plan sponsors in their fiduciary roles.

Our latest research rotates the lens from our traditional focus on participant behavior to a closer look at how plan sponsors are thinking and behaving. How do they view their plans today? What are their goals and philosophies in providing retirement benefits? How are they adapting and shaping the design, investment lineup, communications and administration of their DC plans to meet the growing retirement needs of employees, while fulfilling their roles as fiduciaries?

Our intent is to offer a snapshot of where plans are today, an indicator of where they are headed and a baseline for measuring their continued evolution in the years ahead.

KEY FINDINGS

In examining plan sponsors' goals and actions, we see that, driven by a desire to be caring employers, responsible fiduciaries and astute business leaders, plan sponsors are taking steps to strengthen their DC plans and provide better retirement outcomes for their employees. At the same time, we see addressable issues that may be impeding progress toward plan objectives, as well as a need for a closer alignment between plan sponsors' evolving goals and the strategies currently in place to achieve them. Ultimately, the successful evolution of DC plans will require a concerted effort and continued coordination and support on the part of all parties involved.

Raising the bar for DC plans: Helping to ensure secure retirement outcomes

"Demonstrating a level of caring about employees" and "helping to retain them" top the list of employers' goals for their DC plans, with 83% of plan sponsors considering these goals as highly important ("very" or "extremely"). More than 75% of plan sponsors also rate "increasing the financial security of employees" and "helping to ensure that employees have a financially secure retirement" as highly important, with percentages reaching into the 85%-to-90% range for larger plans (those with $250 million or more in plan assets).

This concern for employees' financial security reaches beyond the realm of retirement to include a more holistic objective. Almost 60% of employers say they have a somewhat high to very high sense of responsibility for the "overall financial wellness of employees."

Evolutionary—not revolutionary—change, with larger plans leading the way

While employers consider financial security-related goals of high importance, the criteria they use for measuring their plans' success do not fully reflect this goal. While 82% view "participant satisfaction" and "investment performance" as highly important measures of success, only about 40% see the number of participants with account balances on track to provide retirement security as an equally important indicator. In addition, the majority of plan sponsors have not readily adopted the innovative plan features (such as automatic enrollment and automatic contribution escalation) designed to help participants achieve secure retirement outcomes. It is not surprising, then, that while 73% of plan sponsors say they are highly effective in "demonstrating a level of caring about employees," only 55% assign these ratings to their effectiveness in helping to ensure that employees have a financially secure retirement.

Among larger plans, however, a much greater percentage of plan sponsors (70%) see themselves as highly effective in achieving their retirement outcome-related goals. While the evolution of DC plans may be proceeding at a modest pace overall, larger plans are moving at a faster clip. These "early adopters" are more eagerly embracing some of the most notable innovations in plan design, including:

- Automatic enrollment (offered by 62% of large plans vs. 43% of all plans)
- Automatic contribution escalation (42% vs. 21%)
- Target date funds (TDFs) (74% vs. 46%)
- One-time re-enrollment of participants into their qualified default investment alternative (QDIA) (14% vs. 7%)

Underlying all of these actions is a focus on proactively placing participants on a strong savings and investing path, a philosophy that 33% of larger plans (vs. 24% of all respondents) say they espouse.

Impediments to change: Perception vs. reality

There appear to be several inhibitors restraining the uptake of features recently introduced to strengthen DC plans. We believe these can be readily addressed, however, through greater clarity on participant needs and a better understanding of fiduciary protections. Consider:

- The most frequent reason given for not implementing a combination of automatic enrollment with automatic contribution escalation is the concern that employees would be upset, presumably due to a perceived loss of some control over their finances. Yet, based on our participant survey, more than 60% of plan participants are in favor of or neutral to such features and less than 20% actually disapprove (and can, of course, choose to opt out).[1]
- More than 50% of respondents do not entirely understand that, as the plan sponsor, they can potentially receive fiduciary protection for participant assets that are defaulted into their plan's QDIA during a re-enrollment.

[1] J.P. Morgan Plan Participant Research 2012.

Better alignment can mean better outcomes

We know from our work with plan sponsors that the most effective way to raise participant success in meeting income replacement needs in retirement is through plan design. It is also important, however, that each component of the DC plan—from design to investments to communications and administration—be coordinated and managed toward a common set of goals. Our survey suggests that there is room for further alignment as DC plans evolve. For example:

- Cost and participant needs are seen as more important drivers of plan design than getting the maximum number of participants to experience adequate income in retirement.
- While most plan sponsors say they provide information and tools to help participants assess whether they are on track in saving for retirement, only 25% consider that promoting this understanding among participants is one of their top three communications goals.
- While more than 70% of plan sponsors believe that it is a highly important objective to work with a provider that focuses on participant outcomes and/or proactively suggests new ideas on how to achieve plan goals, only 10% say they work with a provider who proactively suggests ideas and shares best practices to evolve the plan.

Implications

DC plans have come a long way in the past 30 years, and this evolution must—and will—continue, on all levels, because:

- Participants are still not saving enough.
- Plan sponsors' goals have become more focused on employees' retirement outcomes, but adoption of new features, such as automatic enrollment and automatic contribution escalation, has lagged.
- Policymakers have taken steps to strengthen DC plans, but, in our view, further savings incentives and greater support and clarity on fiduciary protection are needed.

As employees become more dependent on DC plans for retirement security, their expectations for these plans continue to rise. Plan sponsors, in turn, need to be more demanding of, and partner more closely with, plan providers to meet participant needs while also meeting business and fiduciary responsibilities. This presents a significant opportunity for plan providers (and advisors and consultants, in particular) to bring a more proactive, progressive and strategic level of service to plan sponsors. These providers, with their breadth of experience across a variety of plans and approaches, have a well-informed, holistic view of what it takes to fortify DC plans. Together with plan sponsors' in-depth knowledge of participant and business objectives, this makes for a powerful team, capable of strengthening DC plans and providing employees with the satisfying and secure retirements they desire.

Raising the bar for DC plans

SECURE RETIREMENT OUTCOMES AND OVERALL FINANCIAL WELL-BEING FOR EMPLOYEES ARE INCREASINGLY IMPORTANT OBJECTIVES FOR PLAN SPONSORS

Clearly, there has been a role reversal in employer-sponsored retirement plans. DC plans, once merely supplementary vehicles, are steadily replacing defined benefit (DB) plans as the dominant program for retirement savings and investing in the workplace. At the same time, the role of Social Security, long the bedrock of income replacement in retirement, may end up being less important to future retirees, with today's younger workers and higher wage earners (we believe) likely to be the most impacted. The implication for employers is a need to re-evaluate the goals of their DC plans, as well as the strategies for accomplishing these crucial objectives.

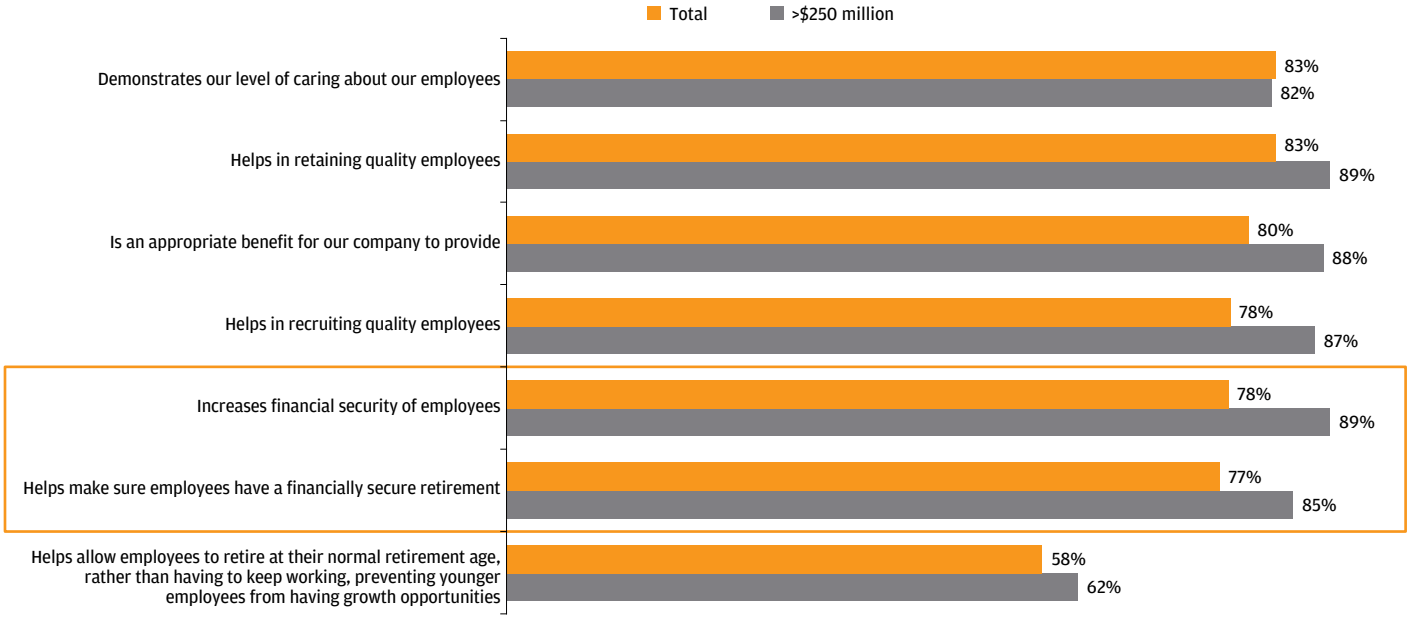
Helping to ensure a secure retirement

Our survey suggests that the main reason why employers offer a DC plan is to attract and retain qualified employees. But employers have other "highly important" goals for their plans, including the ability of the plans to meet the needs of participants.

As seen in **Exhibit 1**, next page, while demonstrating a level of caring about employees and helping to retain them are top goals for employers, more than 75% of employers consider "increasing the financial security of employees" and helping to ensure that "employees have a financially secure retirement" to be highly important goals—not surprising given the critical role DC plans now play in replacing income in retirement. Among larger plans, the percentage that considers these goals to be highly important reaches into the 85%-to-90% range.

Providing employees with financial security in retirement is a highly important goal for plan sponsors

EXHIBIT 1: "HOW IMPORTANT TO YOUR ORGANIZATION ARE EACH OF THE FOLLOWING POTENTIAL GOALS OF YOUR DC PLAN?" (% OF RESPONDENTS RANKING "VERY" OR "EXTREMELY" IMPORTANT)



Note: Total n = 796, >$250M = 125.

Source: J.P. Morgan Plan Sponsor Research 2013.

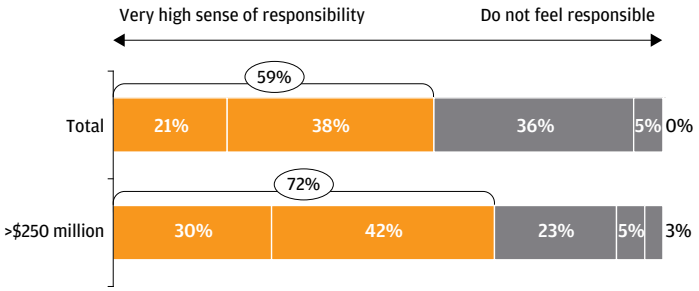
Beyond retirement security

While the main focus of our survey centers on retirement benefits, it is clear that participants' retirement saving behaviors are influenced by a whole set of shifting financial concerns and responsibilities over the course of their working lives. When asked about the level of responsibility they feel for the "overall financial wellness"[2] of employees, 95% of employers feel at least some sense of responsibility, while almost 60% (72% of larger plans) say they feel a somewhat high to very high level of responsibility (**Exhibit 2**).

Employers' sense of accountability at this holistic level is readily understood from an economic perspective when one considers both lost productivity and the costs associated with maintaining an aging workforce with many employees who wish to retire but cannot afford to do so.

Employers have a holistic sense of responsibility for employees' financial wellness

EXHIBIT 2: "AS AN EMPLOYER, WHICH OF THE FOLLOWING BEST DESCRIBES THE LEVEL OF RESPONSIBILITY YOU FEEL FOR THE OVERALL FINANCIAL WELLNESS OF YOUR EMPLOYEES?"



Note: Total n = 396, >$250M = 62. Totals may not equal 100% due to rounding.

Source: J.P. Morgan Plan Sponsor Research 2013.

[2] "Overall financial wellness" is defined to include: saving for goals other than retirement, having an emergency fund, managing debt, the impact of caring financially for other family members, the impact of a spouse's loss of income and the impact of a healthcare crisis, among other things.

In a separate survey of plan participants conducted by J.P. Morgan Asset Management, nearly 80% of participants say they worry about financial pressures when at work, while a third of those who worry admit that financial pressures often consume them at work, if not all the time.[3] This level of distraction clearly has implications for effectiveness on the job.

At the same time, many participants appear likely to delay retirement. In fact, while 48% consider it optimal to retire before age 65, only 20% believe this is a realistic goal. As more people decide, or are forced, to delay their retirement, companies will have to manage an aging labor pool. While companies will have the benefit of more experienced, knowledgeable employees, they may also have to manage potentially higher costs (in terms of both salary and benefits) associated with paying older workers. For example, companies tend to continue to pay the same percentage of an employee's health care premiums, even though the cost of providing health insurance usually rises with age.[4]

In our study of plan sponsors, 58% said a highly important goal for their DC plans is to "help allow employees to retire at their normal retirement age, rather than having to keep working and preventing younger employees from having growth opportunities." While this is a lower percentage than for the other goals in Exhibit 1, we anticipate a heightened awareness of these costs across benefit programs, leading more employers to adopt an increasingly holistic view of employee financial wellness. Inevitably, it is employers' goals that determine plan strategies and will continue to shape the evolution of DC plans.

If I could do it again …
"I would have more people aware of [their] contribution levels … and what it takes to retire at the correct age!"
— Plan Sponsor

[3] J.P. Morgan Plan Participant Research 2012.

[4] Based on Kaiser HRET Survey of Employer-Sponsored Health Benefits, 2012.

Evolutionary—not revolutionary—change

DC PLANS ARE EVOLVING AT A GRADUAL PACE, LED BY LARGER PLANS

The majority of plan sponsors acknowledge the importance of helping employees achieve retirement security, but fewer are taking steps to ensure that outcome. In fact, the measures by which plan sponsors judge plan success do not fully reflect this priority.

Using the right yardstick

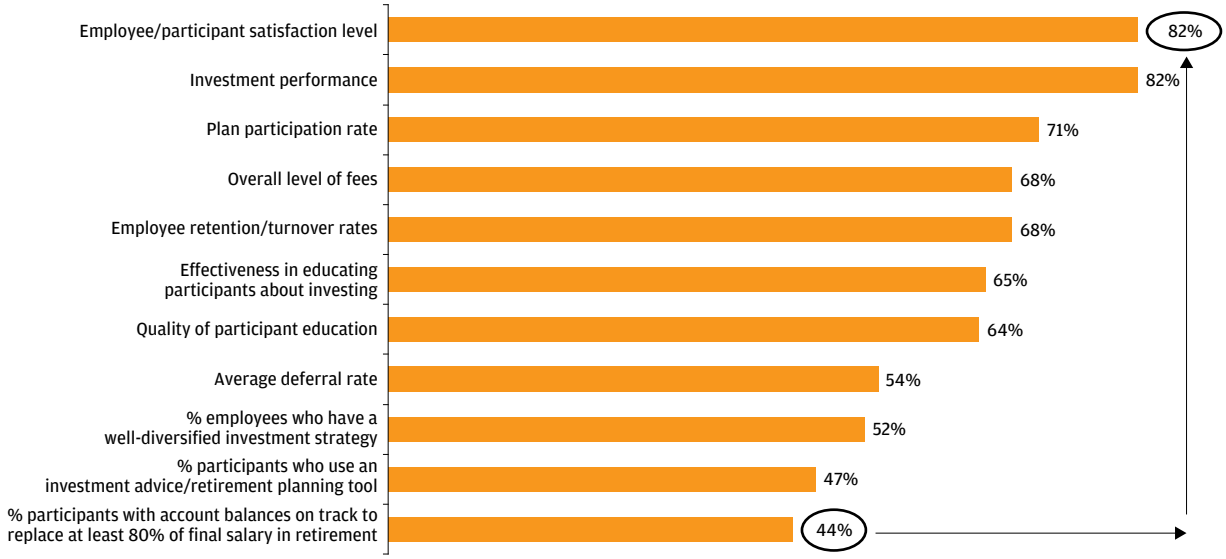
As seen in **Exhibit 3**, next page, more than 80% of plan sponsors consider employee/participant satisfaction and investment performance as highly important criteria for evaluating plan success. For the employer concerned with helping employees achieve a secure retirement, perhaps a clearer, more direct measure of plan success would be the "percentage of participants whose account balances are on track to replace at least 80% of their final salary in retirement" (i.e., within the conventionally accepted range for required income replacement). Providing employees with this sense of security should contribute to a high level of satisfaction. Yet, surprisingly, less than half of employers rate this criterion as highly important.

Achieving secure retirement outcomes

Interestingly, when asked to rate their effectiveness in achieving various goals for their plans, fewer employers saw themselves as highly effective in helping to ensure that employees have a financially secure retirement (55%) or helping employees to retire at their normal retirement age (52%) compared to demonstrating a level of caring about employees (73%) or retaining quality employees (67%) (**Exhibit 4**, next page). Larger plans, however, who are more likely to rate themselves as highly effective across most criteria, distinguish themselves most clearly with respect to these retirement security-related goals, as well as in recruiting quality employees. We believe this may be attributable, at least in part, to the proactive steps being taken by larger plans to improve the retirement security of their employees.

Participant satisfaction is important, but what drives this satisfaction?

EXHIBIT 3: "HOW IMPORTANT ARE EACH OF THE FOLLOWING CRITERIA FOR YOUR EVALUATION OF THE SUCCESS OF YOUR DC PLAN?" (% OF RESPONDENTS RANKING "VERY" OR "EXTREMELY" IMPORTANT)

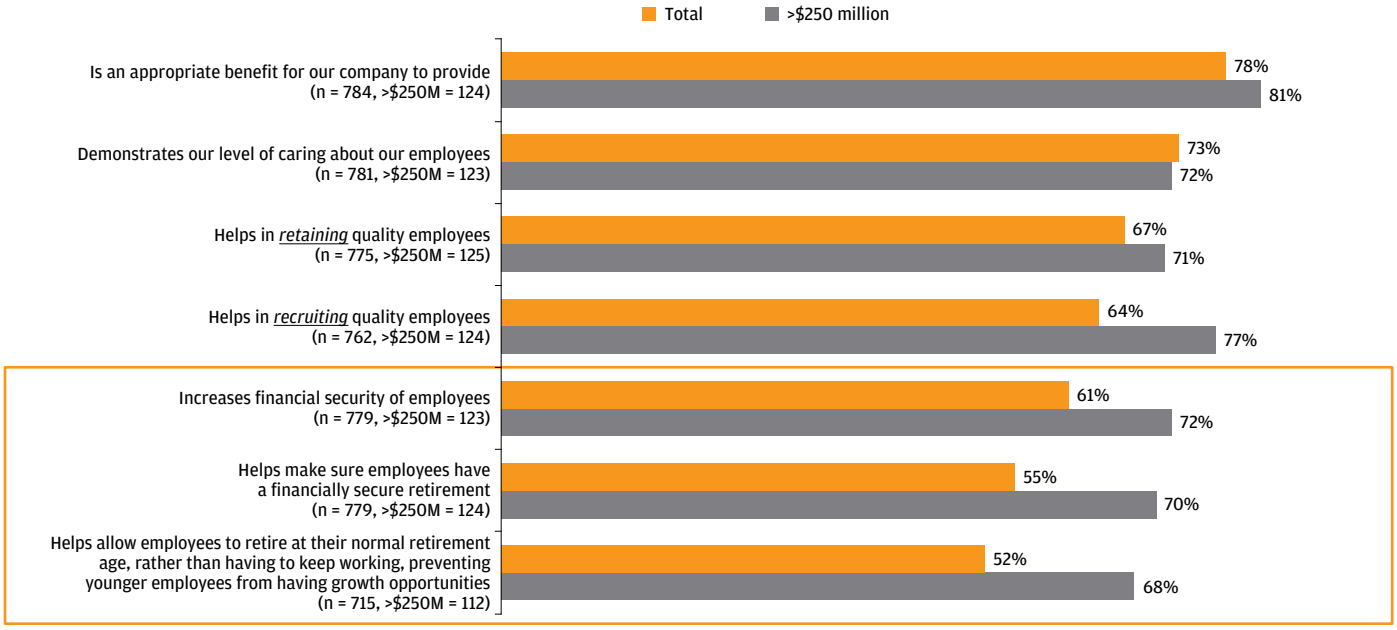


Note: Total n = 796.

Source: J.P. Morgan Plan Sponsor Research 2013.

Larger plans are more likely to rate themselves highly, especially on retirement outcome-related goals

EXHIBIT 4: "HOW EFFECTIVE HAS YOUR DC PLAN BEEN, IN YOUR OPINION, IN MEETING THE FOLLOWING GOALS?" (% OF RESPONDENTS RANKING "VERY" OR "EXTREMELY" EFFECTIVE)



Source: J.P. Morgan Plan Sponsor Research 2013.

Larger plans leading the way

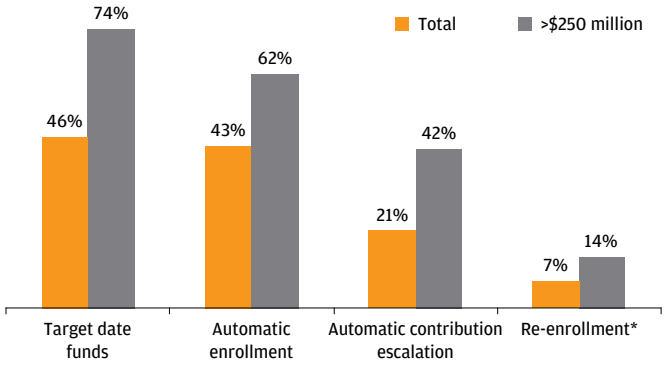
The passage of the Pension Protection Act (PPA) of 2006 took much-needed steps to strengthen the retirement savings component and equip DC plans for their critical role in providing a secure retirement for employees. PPA cleared the way for employers to offer automatic enrollment and automatic contribution escalation, identified investments that qualify as QDIAs (such as TDFs) and provided plan sponsors with fiduciary protection for assets defaulted into these funds.

Our survey indicates that many plan sponsors are employing these innovations and fiduciary protections to improve the effectiveness of their plans in meeting retirement security-related goals, with larger plans serving as "first movers."

Larger plans are most likely to classify themselves as "early adopters." This self-assessment is supported by the percentage of these plans (vs. respondents overall) that have incorporated innovations in plan design (**Exhibit 5A**). Underlying their actions is a more pronounced philosophy for proactively placing participants on a strong savings and investment path (**Exhibit 5B**). This would seem to be at least one explanation for larger plans' apparently higher self-assessed effectiveness in helping employees achieve financial security in retirement.

Larger plans are more likely to adopt new plan features that can help them place participants on a solid savings and investing path

EXHIBIT 5A: "DOES YOUR PLAN OFFER THE FOLLOWING?" (% RESPONDING "YES")

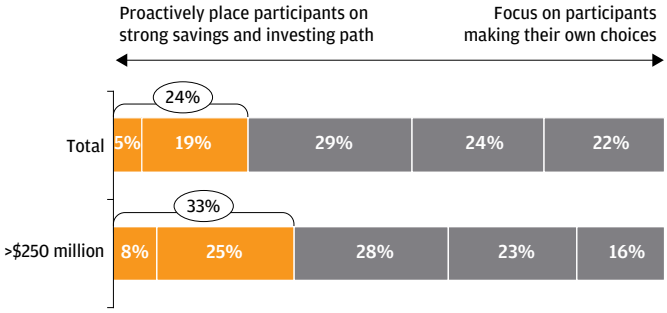


Note: Total n = 796, >$250M = 125.

*When asked their view of a one-time re-enrollment of all participant accounts, "We have already conducted a re-enrollment to the QDIA."

Source: J.P. Morgan Plan Sponsor Research 2013.

EXHIBIT 5B: "WHAT IS YOUR PHILOSOPHY ON DRIVING PARTICIPANT DECISIONS?"



Note: Total n = 796, >$250M = 125. Totals may not equal 100% due to rounding.

Source: J.P. Morgan Plan Sponsor Research 2013.

Impediments to change: Perception vs. reality

A FEW MISCONCEPTIONS MAY BE HOLDING BACK DC PLAN EVOLUTION

Why, if the majority of employers consider it highly important to help employees achieve a financially secure retirement, have more plan sponsors not introduced the innovative plan features designed to support that goal?

Obviously, these are not decisions that are made and implemented across all plans in one dramatic move. Plan innovation is proceeding at a modest pace and will likely continue to do so. Every plan is different and can be expected to have its own specific reasons for, or impediments to, change. Our survey findings suggest, however, that a lack of clarity regarding employee preferences and fiduciary protections may be among the primary barriers slowing the uptake in innovation.

Defining what employees want … and need

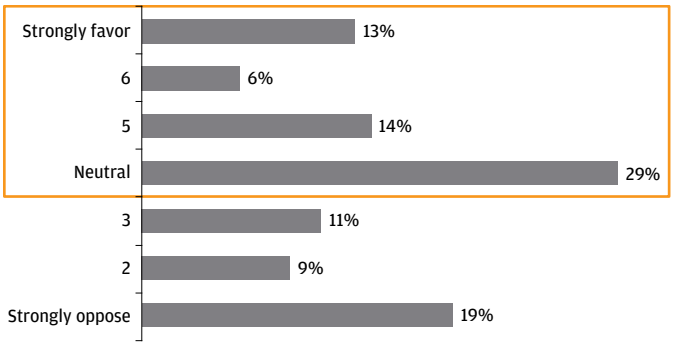
The reason most frequently given by plan sponsors for not introducing automatic enrollment (27% of respondents) or automatic contribution escalation (30% of respondents) is a concern that employees would not approve of these features, presumably due to a perceived loss of control.

Our recent survey of plan participants suggests greater support for these features than employers might realize. In fact, in that survey, participants were asked whether they would favor employers offering a combination of automatic enrollment and automatic contribution escalation, with money invested in a mix of stocks and bonds appropriate for the age of the employees, assuming that employees were informed in advance and could change or cancel these deductions at any time or amend their investment choices. Results show that more than 60% of participants are in favor of or neutral on such an offering, while less than 20% are strongly opposed (**Exhibit 6**, next page). What's more, our participant survey also found that two-thirds of respondents have a high level of trust in their employers' ability to select an appropriate retirement plan provider and a set of investment options. Further indications of participant satisfaction (or perhaps of the inertia these features are meant to address) can be seen in industry research that shows, once enrolled in a plan with automatic enrollment and automatic contribution escalation, less than 10% of participants ever opt out.[5]

[5] Defined Contribution Institutional Investment Association (DCIIA), 2012 Plan Sponsor Survey.

Most individuals favor or are neutral on combining automatic enrollment with automatic contribution escalation

EXHIBIT 6: "TO WHAT EXTENT DO YOU FAVOR OR OPPOSE EMPLOYERS OFFERING BOTH AUTOMATIC ENROLLMENT AND AUTOMATIC CONTRIBUTION ESCALATION?"



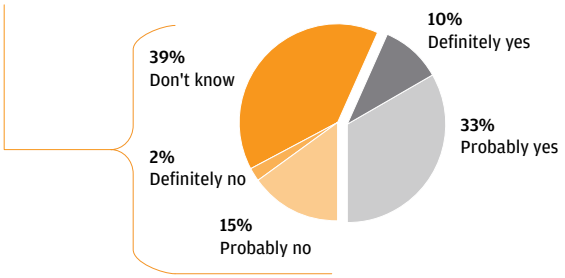
Note: Total n = 1,009. Totals may not equal 100% due to rounding.

Source: J.P. Morgan Plan Participant Research 2012.

Lack of clarity on fiduciary protection may be deterring re-enrollments

EXHIBIT 7: "TO THE BEST OF YOUR KNOWLEDGE, WOULD YOU AS THE PLAN SPONSOR RECEIVE FIDUCIARY PROTECTION FOR PARTICIPANTS WHO WERE DEFAULTED INTO YOUR PLAN'S QDIA DURING A RE-ENROLLMENT?"

56%
of plan sponsors aren't aware of the potential to receive fiduciary protection for participant assets that were defaulted into their plan's QDIA during a re-enrollment.



Note: Total n = 796, >$250M = 125. Totals may not equal 100% due to rounding.

Source: J.P. Morgan Plan Sponsor Research 2013.

How "safe" is the harbor?

Since the inception of PPA, plan sponsors have grown to understand the ERISA safe harbor protections provided by QDIA rules as they apply to a newly eligible employee (i.e., when the employee is automatically enrolled in a DC plan and is defaulted into a QDIA, such as a TDF). Our survey results suggest, however, that sponsors are less confident in their understanding of these fiduciary protections as they apply to a one-time re-enrollment, for which the same protections may be available (see "What is a plan re-enrollment?").

When asked whether, to the best of their knowledge, they would receive fiduciary protection for participants defaulted into their plan's QDIA during a re-enrollment, 56% of plan sponsors said they are not aware of the potential protection (39% don't know, while 15% believed they probably would not and 2% believe they definitely would not be protected) (**Exhibit 7**). Greater clarity on this issue could lead more plan sponsors to pursue this option, which may dramatically improve a plan's asset allocation.

WHAT IS A PLAN 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 the plan's QDIA (usually a TDF) based on their date of birth. All plan participants are automatically moved into the QDIA on a certain date unless they make a new investment election during a specified time period.

Better alignment can mean better outcomes

DC PLANS ARE STRONGEST WHEN PLAN COMPONENTS ARE STRUCTURED TO SUPPORT A COMMON SET OF GOALS

For DC plans, superior performance requires that all components—plan design, investments, communications and administration—complement and reinforce each other in achieving plan objectives. It follows that, as employers raise the bar on their DC plans and strengthen them by adding new features, these components will need to evolve in sync.

> If I could do it again …
> *"I'm not sure. I know [that] I and others in the decision-making process are not fully aware of what we have and how it works together."*
> — Plan Sponsor

EXHIBIT 8: "FOUR COMPONENTS OF A DC PLAN"

Source: J.P. Morgan Asset Management.

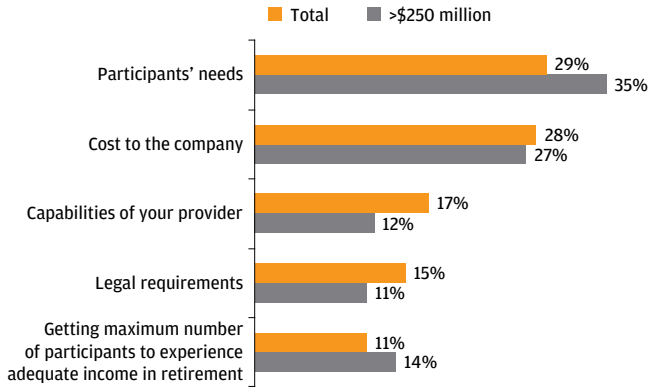
Plan design: Opportunities to impact participant behavior

We know from our work with plan sponsors and their employees that participant savings and investing behaviors are one of the primary determinants of success in reaching the end of one's working years with sufficient income to enjoy a secure retirement. We also know that plan design is perhaps the DC plan component most capable of impacting participant behavior. As previously discussed, policymakers have provided support to plan sponsors for implementing new design features that can help place participants on a strong saving and investing path. That support takes the form of fiduciary protections for plan sponsors who introduce such design innovations as automatic enrollment and automatic contribution escalation. But, despite insufficient savings rates for many participants, to date, a limited number of employers have combined these two features to encourage savings.

A look at what drives plan design decisions (**Exhibit 9**) offers some insight on why more plans have not implemented these new features. First, automatic enrollment and automatic contribution escalation, if effective, can increase plan sponsor costs for matching contributions. This means that the top-two drivers of plan design—participants' needs (a more important driver for larger plans) and costs to the company—are often competing against each other. Second, while plan sponsors consider "getting the maximum number of participants to experience adequate income in retirement" a highly important goal for the plan overall, it is not high on the list as a key driver of plan design decisions (although larger plans give it somewhat more weight).

Drivers of design decisions point to conflicting objectives that are not fully aligned with goals

EXHIBIT 9: "DO YOU BASE YOUR COMPANY'S PLAN DESIGN DECISIONS PRIMARILY ON ... "



Note: Total n = 796, >$250M = 125.

Source: J.P. Morgan Plan Sponsor Research 2013.

As seen in the following two examples, strategically structuring plan design features may help address competing objectives such as cost and participant satisfaction.

Matching contributions are the traditional design component for encouraging employees to save more in their DC plans, and nearly three-quarters of respondents (more among larger plans) offer a match. Only about 20% of those providing a match, however, say they would be highly likely to change the structure of their existing matching contributions to encourage participants to save more in the plan.

Here again we see competing objectives, since addressing participant needs by simply increasing the employer match clearly has cost implications. It should be noted that participants generally choose to defer a percentage of their income up to, but not beyond, the limit of the match (e.g., contributing 3% of their income if the employer matches dollar-for-dollar, up to 3%). Therefore, it may be possible for the plan sponsor to encourage greater savings, without increasing its cost, by stretching the match (e.g., 50 cents on the dollar) on a higher deferral rate (e.g., up to 6% of income).

Automatic enrollment and automatic contribution escalation features can be an effective means for overcoming inertia and encouraging employee participation and savings, but only when appropriately structured. Our research on participant behavior shows that, in fact, those who are automatically enrolled generally stay at the default rate and don't contribute more. As a result, they can end up saving less than those who independently set their deferral rate.[6] We believe that employer-defined deferral rates can be higher, and combined with automatic contribution escalation. Unless properly constructed, such programs may, in a sense, stall savings rates among defaulted employees short of the level required to adequately replace income in retirement.

Investments: Inform or simplify?

Clearly, the shift from DB to DC plans has placed much of the investment decision-making on the individual participant. Nevertheless, plan sponsors still have responsibility for the prudent selection and monitoring of the investment options offered by the plan. They also have responsibility for prudent participant investing—the allocation of account assets in accordance with sound portfolio allocation theories—in a way that meets the needs of the participant and is designed to avoid major losses.[7]

Yet, we know from our research that participants continue to feel overwhelmed by the confusing array of complex choices they are faced with making to ensure their retirement security. In our participant survey, more than half of respondents said they did not have enough talent (i.e., knowledge and time) to plan for retirement on their own.

[6] J.P. Morgan Asset Management, *Ready! Fire! Aim?* 2012.

[7] Fiduciary implications: Using re-enrollment to improve target date fund adoption, C. Frederick Reish & Bruce Ashton, Drinker Biddle & Reath LLP, June 2011.

The result is that participants often make poor investment choices that may leave them either without adequate diversification or overexposed to risky asset classes.

The crux of the challenge for plan sponsors is to balance this realistic view of participant preparedness (not to mention inadequate savings behavior) with their own fiduciary responsibilities and plan goals, all while getting participants to a financially secure retirement.

There are two fundamental approaches plan sponsors can take to meet this challenge:

- Provide participants with more information/education
- Simplify investment decision-making

While additional investment information may help some employees to make more appropriate investment decisions, our participant survey suggests that the majority (65%) of employees don't take the time to read all of the investment information they already receive.

On the other hand, there are several ways to simplify investment decision-making:

- Simplify the core lineup. This implies a smaller number and/or a better organized presentation of asset class options from which participants can build a diversified portfolio. DC plan options were initially limited, but then grew in response to participants' demands, in some cases expanding to unwieldy and confusing proportions.

  Our survey shows mixed views among plan sponsors today, with some planning to increase and others to decrease fund options. The average number of funds for plans in our sample was roughly 13.7, just slightly below plan sponsors' stated ideal of 14.2 funds, suggesting, perhaps, that the expansion phase may be winding down. This would be in line with retirement industry analysis that encourages plan sponsors to simplify investment lineups.[8]
- Provide professionally managed options, such as TDFs, that are designed to provide diversified, retirement-date-appropriate portfolios.

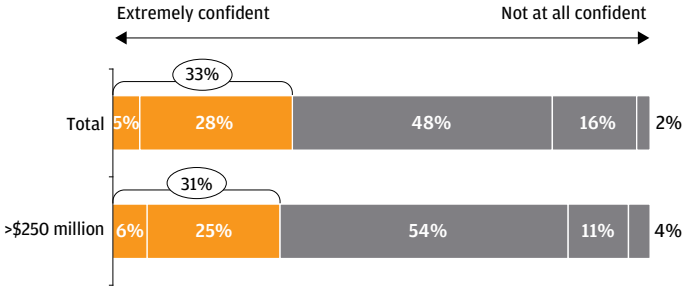
> If I could do it again …
> *"At least at the earliest stages, we would have offered [fewer] core choices, to streamline the plan and avoid confusion."*
> — Plan Sponsor

Despite participant education efforts and the availability of simplified investment decision-making options, only about one-third of plan sponsors surveyed said they were highly confident that the majority of participants has the appropriate asset allocation, while 48% were only somewhat confident (**Exhibit 10**).

This lack of confidence seems warranted, given our own analysis of how unsuccessful participants have been in using core menus to build their own retirement portfolios. Findings indicate that most "do-it-yourself" (DIY) participants remain underdiversified, have skewed risk exposure and tend to leave their portfolio on autopilot, failing to make adjustments or to rebalance over time. And the results speak for themselves. In a study comparing three-year performance between those invested in TDFs and those constructing their own investment portfolios, DIYs had considerably lower median returns than did TDF investors (7.0% for DIYs vs. 8.6% for TDF investors) and a much wider dispersion between best and worst

Only one-third of plan sponsors are highly confident that participant asset allocations are appropriate

EXHIBIT 10: "HOW CONFIDENT ARE YOU THAT THE MAJORITY OF YOUR PARTICIPANTS HAVE THE APPROPRIATE ASSET ALLOCATION?"



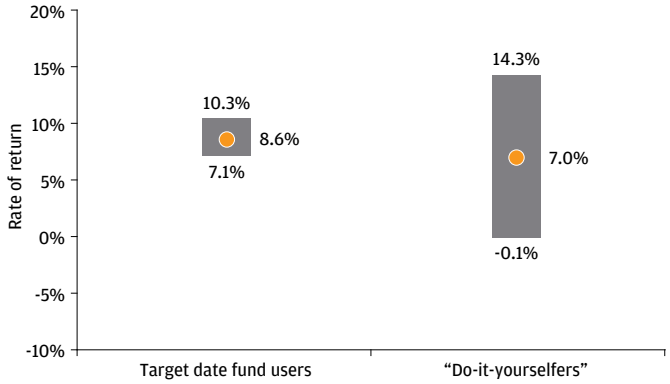
Note: Total n = 796, >$250M = 125. Totals may not equal 100% due to rounding.
Source: J.P. Morgan Plan Sponsor Research 2013.

[8] See, for example, "DC plans need simpler menus, DCIIA study finds," *Pensions & Investments*, May 6, 2013.

performers (from negative returns of -0.1% to positive returns of 14.3% for DIYs vs. positive returns from 7.1% to 10.3% for TDF investors) (**Exhibit 11**).

TDF investors have outperformed "do-it-yourselfers"

EXHIBIT 11: "STANDARDIZED THREE-YEAR PERSONAL RATES OF RETURN BY INVESTMENT STRATEGY (LOW, MEDIAN, HIGH)"

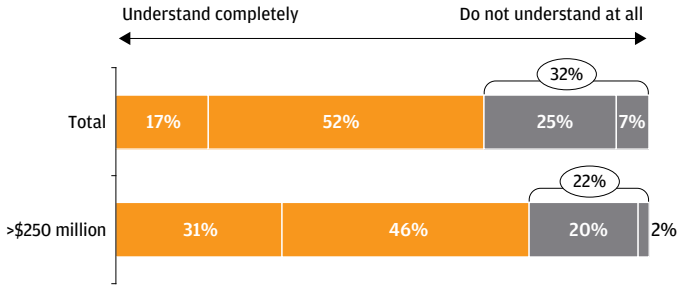


Source: J.P. Morgan Retirement Plan Services proprietary research. Analysis measurement period is December 31, 2009, through December 31, 2012. The above data represents a sampling of participant data. It does not represent the returns of any individual product or portfolio. Exclusive reliance on the 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 inside back cover for "Important Disclosures for Personal Rate of Return Methodology" for additional information.

From our perspective, this suggests that the trend toward offering TDFs has much further to run. In that case, one of the challenges for plan sponsors is to be well-informed of the investment strategies and glide paths available in the marketplace, as well as their distinguishing characteristics. When plan sponsors in our survey who offer TDFs were asked to rate their level of understanding of the methodology used to construct those offerings, roughly one-third say they understand them less than reasonably well (i.e., somewhat understand [25%], understand a little [5%], don't understand at all [2%]) (**Exhibit 12**). As a result, we believe plan sponsors should inform themselves and look to their advisors/consultants for guidance in selecting the most appropriate strategies for their unique participant bases.

Some plan sponsors do not fully understand their TDFs' methodology

EXHIBIT 12: "PLEASE RATE YOUR LEVEL OF UNDERSTANDING OF THE METHODOLOGY USED TO CONSTRUCT THE TARGET DATE FUNDS IN YOUR DC PLAN"



Note: Total n = 440, >$250M = 93. Totals may not equal 100% due to rounding.
Source: J.P. Morgan Plan Sponsor Research 2013.

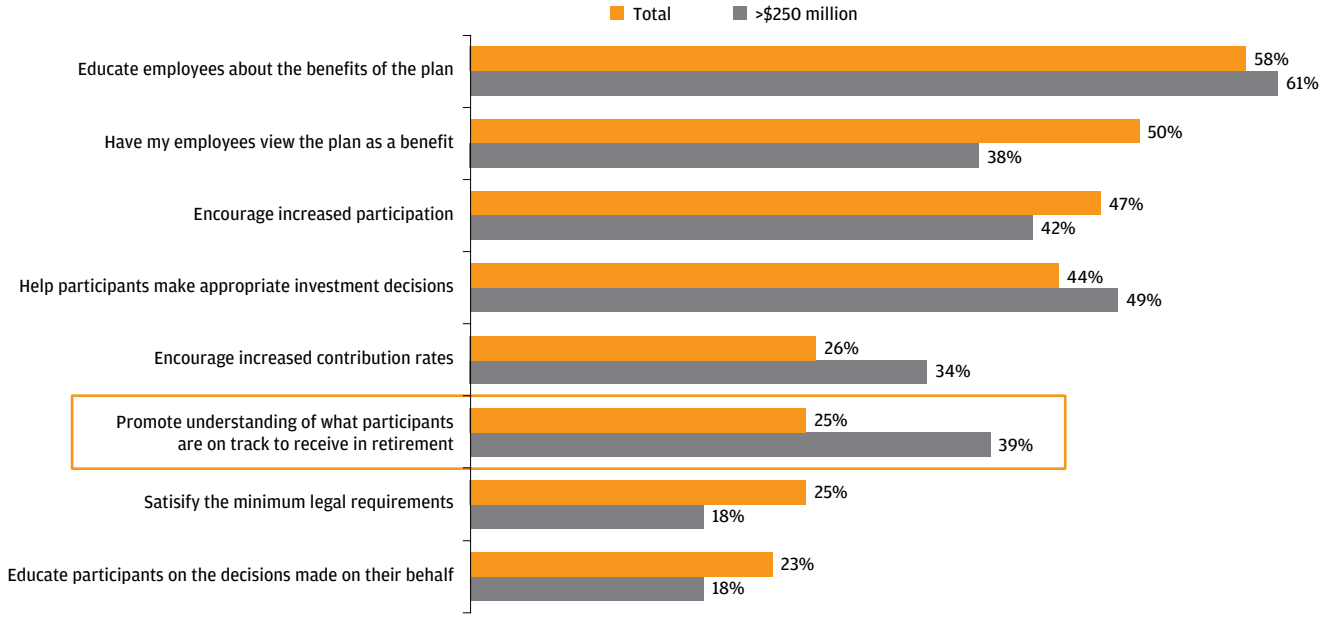
Communications: Focus on individual participant outcomes

Plan sponsors appear to view their communications programs, at least in part, as a promotional tool, something to help employees understand their benefits and to ensure that employees appreciate the value of the benefits the employer provides (**Exhibit 13**, next page). Encouraging participation and helping participants make appropriate investment decisions rank next on the list of important goals. Echoing the key drivers of plan design decisions, only 25% of plan sponsors view promoting an understanding of what participants are on track to receive in retirement as a "top three" communications goal. On this score, larger firms stand out, with 39% considering outcome-focused communications a high priority, which aligns with the more retirement outcome-directed goals they have for their plans. This suggests that, as plans continue to focus on helping employees along the path toward a secure retirement, their communications strategy will have to evolve, along with plan design, to support this shift.

As participants take advantage of simplified and automatic investment options, communications can focus on basic savings behaviors—getting more people into the plan and increasing contributions—to levels that can help ensure a financially comfortable retirement.

Helping participants see what they are on track to receive is not a "top-three" goal

EXHIBIT 13: "AS IT RELATES TO YOUR PLAN COMMUNICATIONS, PLEASE SELECT YOUR THREE MOST IMPORTANT GOALS" (% THAT SELECTED AS ONE OF TOP THREE)



Note: Total n = 796, >$250M = 125.

Source: J.P. Morgan Plan Sponsor Research 2013.

We have learned from our research that one of the most effective ways to motivate participant behavior is by personalizing the savings message so that employees can see what they need to do to help ensure their retirement security. In fact, a study of eligible employees with access to their projected income at retirement on the J.P. Morgan record-keeping platform showed that those employees improved their overall income replacement by 16% between 2005 (when the income replacement projection tools were introduced) and 2012 (**Exhibit 14A**, next page). In addition, the percentage of participants on track to receive income replacement of at least 70% at retirement increased by 125% over the same period (**Exhibit 14B**, next page). The largest drivers of these increases were the length of time a participant had been exposed to the projection and the interaction a participant had with modeling tools that explored different savings scenarios.[9]

In our plan sponsor survey, 64% of respondents (77% among larger plans) say that they or their plan providers make information or tools available that indicate if participants are on track in terms of retirement savings or that project participant account balances at the target age for retirement. This is encouraging and suggests that plan sponsors are learning how to motivate employees to overcome their own inertia, actively engage in planning for retirement and save enough to provide for a secure retirement lifestyle. Perhaps less encouraging is the fact that, despite offering these tools for individualized analysis, most plan sponsors (62%) describe their approach to participant communications as providing "general communications to our participant base," while only 22% describe their approach as providing "personalized communications at the individual participant level." Here, too, the larger plans are likely to provide less generalized and more targeted information (**Exhibit 15**, next page).

[9] J.P. Morgan Retirement Plan Services Proprietary Research.

Exposure to personal income replacement projections is a strong motivator of retirement savings

EXHIBIT 14A: "OVERALL INCOME REPLACEMENT RATES" (2005–2012)

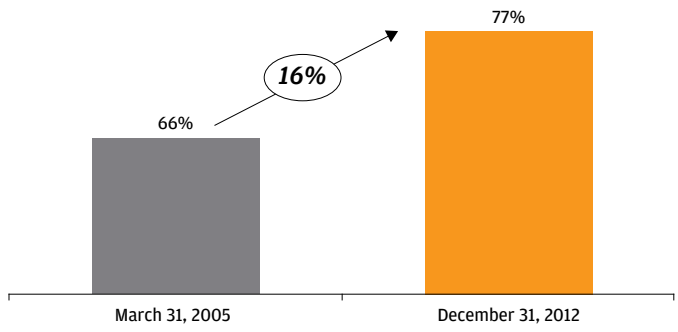
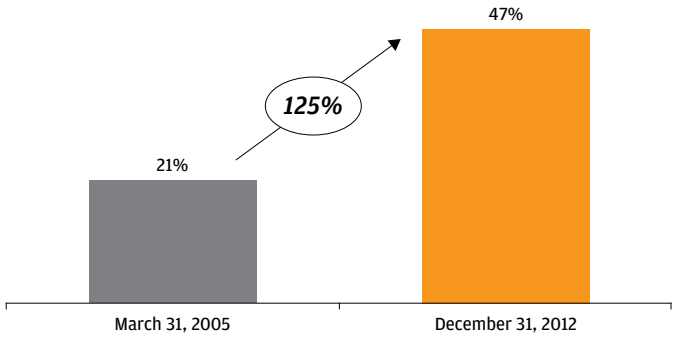


EXHIBIT 14B: "PERCENTAGE OF PARTICIPANTS ON TRACK TO RECEIVE AT LEAST 70% INCOME REPLACEMENT" (2005–2012)

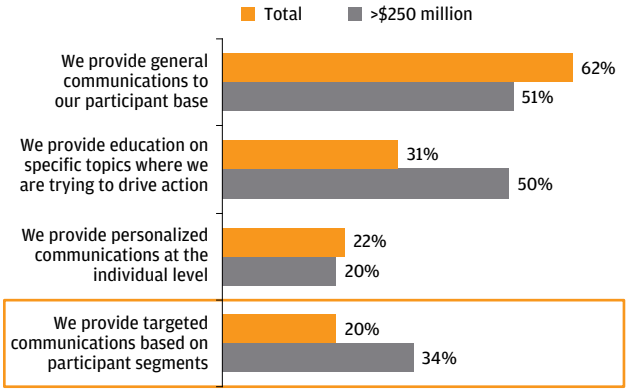


Note: Total n = 800,021 participants. Source: J.P. Morgan Retirement Plan Services Proprietary Research.

Assumptions: Income replacement results reflect the experience of participants earning between $14,500 and $10 million annually who were contributing to their retirement plan as of December 31, 2012. Retirement age is 65. If over 62, retirement age would be current age plus three years. Based on information provided for annual salary, state of residence, hire date, date of birth and gender. If not provided, gender defaults to female. Tax filing status defaults to single if state of residency is the same as tax filing state. Includes Social Security, which is calculated based on normal Social Security retirement age, as per federal regulations. The assumed income growth rate is 5%. Income growth rate represents the average increase in salary expected over time, which is the approximate historical rate of growth (including inflation) for a typical person's salary. The projection considers the IRS annual compensation limit, indexed periodically. Contribution amount is based on current election in defined contribution plan. Annual retirement income estimate and initial risk category are calculated using the investments currently held in retirement plan account. Balances from brokerage account(s) or loan(s) will not be included in forecast. Income replacement calculation includes balances from other plans that are turned on for Retirement Dream Machine. Retirement Dream Machine is an investment education tool offered by J.P. Morgan Retirement Plan Services pursuant to the Department of Labor's Interpretive Bulletin 96-1.

Only 20% (34% of larger plans) provide targeted communications, tailored to the participant

EXHIBIT 15: "WHICH ONE OF THE FOLLOWING BEST DESCRIBES YOUR PLAN'S APPROACH TO PARTICIPANT COMMUNICATIONS?"



Note: Total n = 796, >$250M = 125. Multiple responses accepted.

Source: J.P. Morgan Plan Sponsor Research 2013.

Plan administration: Beyond operational and cost efficiency

Plan sponsors have a range of objectives they consider highly important for the administration of their plans. The most critical goals are related to operational efficiency, cost efficiency and meeting legal requirements. This is followed by ensuring that participant services are highly satisfactory. To remain viable, plan providers must achieve these fundamental goals.

The final two highly important objectives are more demanding: to work with a provider who (1) focuses on participant outcomes and (2) proactively brings new ideas to the plan sponsor on how to achieve plan goals.

How are plan providers doing in the eyes of plan sponsors? In aggregate, very well: the majority is highly satisfied with their provider (68% of all plan sponsors and 79% of those representing larger plans). It appears that providers are delivering extremely well in terms of their fundamental services. Results suggest, however, that beyond highly commendable execution on the essential administrative functions, there appears to be an opportunity for providers to distinguish themselves by delivering a more proactive, progressive and strategically supportive level of service.

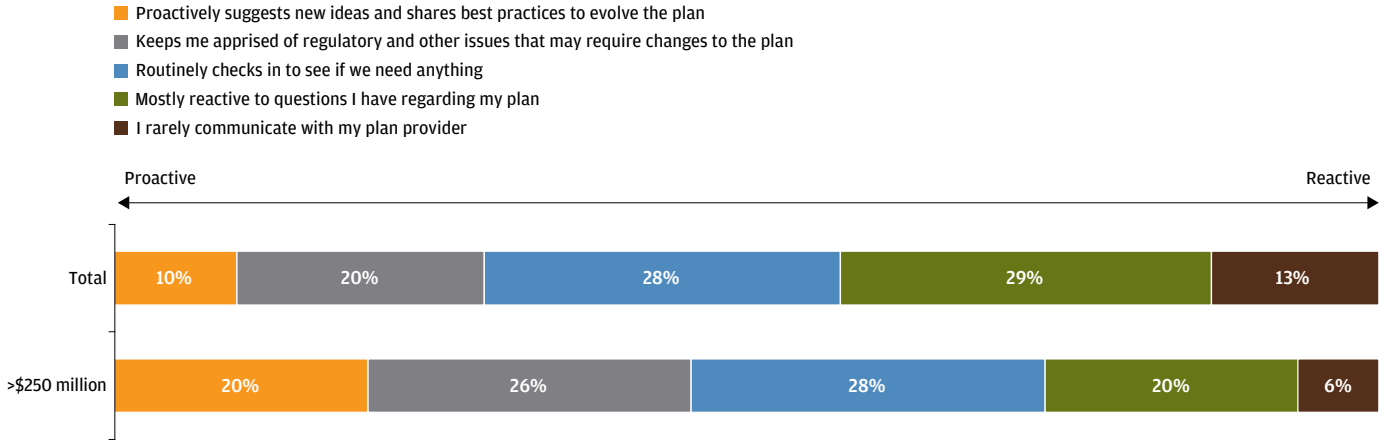
For example, despite giving high satisfaction ratings to their providers:

- Only 10% of plan sponsors describe their plan provider as one who proactively suggests new ideas and shares best practices to evolve the plan (increasing to 20% among larger plans) (**Exhibit 16**).
- Only 18% say their plan provider's role in helping to measure administrative plan performance includes providing detailed documentation that is designed to support strategic objectives by enabling the plan sponsor to measure the plan's progress on each of its goals (true for 25% of larger plans) (**Exhibit 17**).

As the evolution of DC plans continues, plan sponsors are likely to hold themselves *and their plan providers* to higher standards.

More proactive providers are required, especially among those servicing smaller plans

EXHIBIT 16: "WHICH OF THE FOLLOWING BEST DESCRIBES YOUR CURRENT RELATIONSHIP WITH YOUR PLAN PROVIDER?"

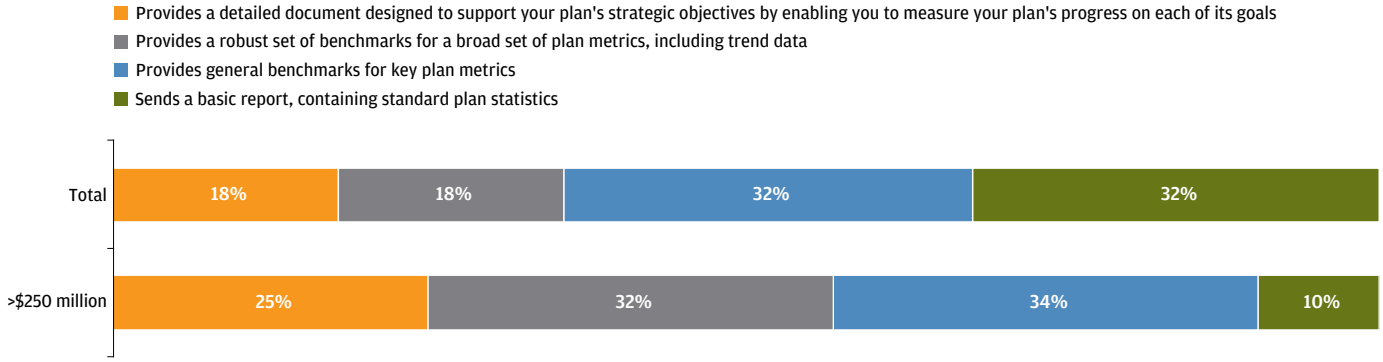


Note: Total n = 796, >$250M = 125.

Source: J.P. Morgan Plan Sponsor Research 2013.

Help is needed in measuring the plan's administrative effectiveness

EXHIBIT 17: "WHICH ONE OF THE FOLLOWING COMES CLOSEST TO YOUR PLAN PROVIDER'S ROLE IN HELPING YOU MEASURE YOUR PLAN'S PERFORMANCE IN TERMS OF ADMINISTRATION?"



Note: Total n = 796, >$250M = 125. Totals may not equal 100% due to rounding.

Source: J.P. Morgan Plan Sponsor Research 2013.

Implications

THE CONTINUED EVOLUTION OF DC PLANS WILL REQUIRE MORE FROM PLAN SPONSORS, PROVIDERS, PARTICIPANTS AND POLICYMAKERS ALIKE

DC plans have come a long way, but to help ensure adequate income in retirement for America's workforce, these plans must continue to evolve. Viewed in combination with three decades of industry research and experience, the findings from our plan sponsor survey have clear implications for all involved, and, in particular, for plan sponsors and their providers, as well as advisors and consultants.

Implications for plan sponsors

With DC plans now a necessity for employees as a source of retirement income, plan sponsors must act to strengthen their plans—regardless of plan size—not only for the benefit of participants, but also to ensure the competitive advantage of their plans in attracting and retaining qualified employees (while also meeting fiduciary responsibilities).

Employers, led by those with larger plans, are taking steps to fortify their DC plans, implementing innovative features and leveraging fiduciary protections that encourage plan sponsors to proactively place participants on a strong path to a secure retirement. Here are some of the factors we view as critical to plan sponsors' success in strengthening their plans over the next several decades.

Well-defined goals and an accurate yardstick for measuring success

Demonstrating a level of caring, increasing participant satisfaction and attracting and retaining qualified employees are important goals. In our view, helping participants save what they need to have adequate replacement income in retirement is not an *additional* goal but, rather, one that can lead to the fulfillment of the others. Along these lines, one measurable and clear indicator of a plan's success is the number of employees on track to experience this positive retirement outcome.

An intimate knowledge of employees and what motivates savings and investing

There is wide variation among employees in financial sophistication, decision-making proclivity and time available for managing retirement assets. Some, for example, are "do-it-yourselfers" and others want to delegate decision-making. A fully effective DC plan should be based on a deep understanding of the participants. To the extent possible, information should be acquired about participants' preferences for information and support on saving for retirement; this will allow more targeted, and therefore more effective, communications and educational programs. It must also be realized that a certain proportion of workers will allow inertia to prevent them from enrolling in DC plans, updating their

contributions or re-balancing their investments. This calls for the most productive use of automatic enrollment, automatic contribution escalation and re-enrollment and the most informed choice of target date funds or other asset allocation funds. An in-depth knowledge of participants will also lead to the most effective methods of motivating savings and the use of available plan provider tools to assist participant decision-making. The key is to seek an understanding of the employee base and to use that information to offer targeted educational programs and design the best plan for the organization's employees.

A more holistic view of employees' overall financial wellness

A better perspective of how benefit programs are interconnected can lead to greater satisfaction among employees, as well as greater cost efficiencies for employers. Taking steps to help employees manage their current financial concerns can lessen distractions at work and potentially improve productivity. And helping employees to start saving early and stay on track to retire at their targeted date may help employers control costs associated with an aging workforce.

A thorough understanding of plan sponsors' fiduciary responsibilities and protections, especially as policies change

Lack of a clear understanding regarding fiduciary protections may deter plan sponsors from taking a more proactive role in putting employees on a solid path to a secure retirement (e.g., by conducting a one-time re-enrollment). As policymakers reinforce the fiduciary safety net to strengthen DC plans, plan sponsors will need to stay informed of the implications for their plans and participants.

An awareness of new developments in plan features and services and an openness to adopting those that address the organization's goals for the DC plan

Plan sponsors should be attentive to and learn from what their peers/competitors are doing, where these peers have been successful and what might work/not work for their own plans.

Synchronized development and alignment of goals across plan design, investments, communications and administration

If the goal is to attract and retain employees by helping to provide them with a financially secure retirement, then plan design, investment options and participant communications should work together to motivate the required participant behaviors. Administration/recordkeeping should make it easy for participants to put the plan to use and for plan sponsors to test the efficiency and effectiveness of the various design, investment and communications options they have put in place.

Every plan and participant population is unique, and there is no single formula for plan success. Now, more than ever, it is important for plan sponsors to continue the progress they have made in fortifying their DC plans, to consider the critical factors for success listed above and, in close coordination with their plan advisors and providers, to persist in their efforts to strengthen their plans.

Implications for plan advisors/consultants

Employees are relying more on and demanding more from their employers. As a result, employers have raised the bar for their DC plans and need to demand more from their DC plan advisors and providers. As previously discussed, while plan sponsors are quite satisfied today with their plan providers, few indicate that they are receiving a proactive level of service. *The same can be said with regard to plan advisors/consultants.*

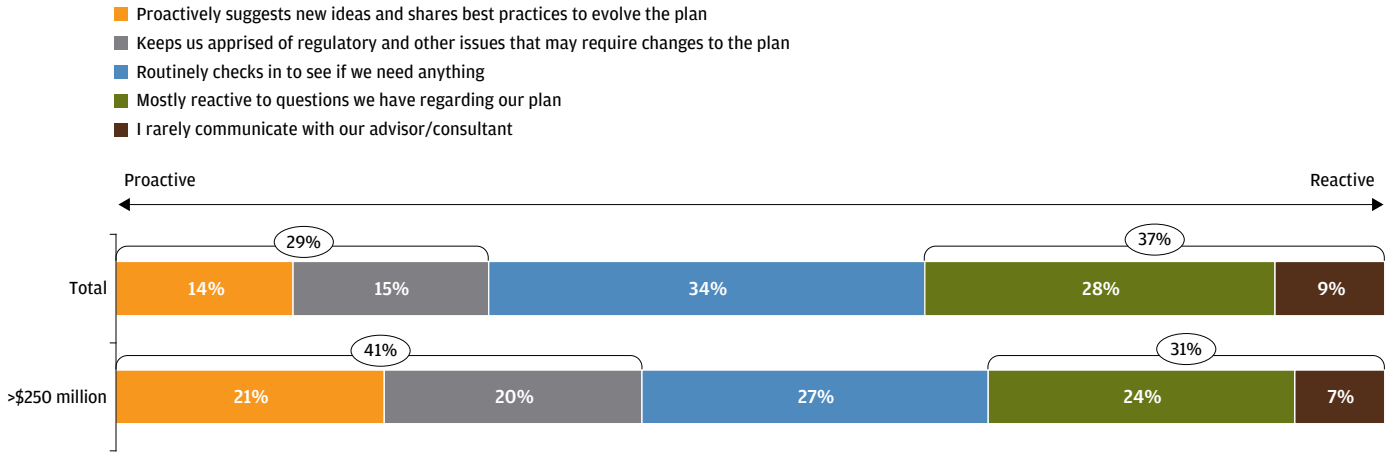
In our survey, roughly three-quarters of respondents use an advisor/consultant. Among those who do, 74% are either very or extremely satisfied with their primary advisor. Yet, less than 30% say that their advisor suggests new ideas and shares best practices to evolve the plan or keeps them apprised of regulatory and other issues that may require changes to the plan; the percentage is higher, at 41%, for larger plans (**Exhibit 18**, next page).

Our survey findings indicate that plan sponsors will increasingly value a proactive relationship with their advisors/consultants as they strive to strengthen their DC plans. This relationship will need to go beyond routinely checking in to see what is needed. In our view, this presents a significant opportunity for advisors/consultants to:

- Keep plan sponsors apprised of developments in terms of both regulatory changes and innovate features and services available for their plans that they may want to consider.

Advisors can distinguish themselves through proactive, strategic ideas—especially in advising smaller plans

EXHIBIT 18: "WHICH OF THE FOLLOWING BEST DESCRIBES YOUR ORGANIZATION'S CURRENT RELATIONSHIP WITH THE PLAN'S ADVISOR/CONSULTANT?"



Note: Total n = 613, >$250M = 99. Totals may not equal 100% due to rounding.

Source: J.P. Morgan Plan Sponsor Research 2013.

- Help plan sponsors evaluate the potential impact of plan changes on participant savings and investing behavior, and, ultimately, on retirement outcomes.
- Provide expert advice on what distinguishes QDIA options, such as TDFs, and which QDIAs are most appropriate for their participants.
- Offer plan sponsors a more holistic view of the cost-benefit trade-offs associated with improving the effectiveness of their DC plan.
- Assess the extent to which the various elements of their plan—design, investments, communications and administration—are coordinated and aligned in working toward plan goals.

We believe that this proactive, progressive and strategic advice will be increasingly sought after by all plan sponsors. Larger plans will require support as they continue to break new ground, while smaller plans will look to their advisors/consultants for guidance in applying the lessons learned by larger plans to their own situations and challenges.

A collaborative effort

Providing more Americans with the experience and satisfaction of a secure retirement calls for the continued evolution of DC plans, with all parties contributing. Participants need to save more and be more engaged in planning for their retirement. Employers must continue to strengthen their plans, while, at the same time, meet their responsibilities as business leaders and fiduciaries. Policymakers, in our view, must continue to motivate individuals to save and invest, as well as help employers shoulder the fiduciary responsibilities involved in providing retirement security to their employees. And, finally, plan providers, as well as advisors and consultants, can play a crucial role by working with plan sponsors to design and develop plans that address employers' business needs and goals, leverage policymakers' support and educate and encourage employees to save and invest.

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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.

Certain underlying funds of target date funds may have unique risks associated with investments in foreign/emerging market securities and/or fixed income instruments. International investing involves increased risk and volatility due to currency exchange rate changes, political, social or economic instability and accounting or other financial standards differences. Fixed income securities generally decline in price when interest rates rise. Real estate funds may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector, including, but not limited to, declines in the value of real estate, risk related to general and economic conditions, changes in the value of the underlying property owned by the trust and defaults by the borrower. The fund may invest in futures contracts and other derivatives. This may make the fund more volatile. The gross expense ratio of the fund includes the estimated fees and expenses of the underlying funds. A fund of funds is normally best suited for long-term investors.

Important Disclosures for Personal Rate of Return Methodology: Rate of return is calculated for active participants by an investment strategy using the Modified Dietz method and is based upon volatility between the highest rate of return and the lowest rate of return associated with each investment strategy among such participants. Services associated with the identified investment strategies were available as of the last day of the measurement period, but may not have been available throughout the measurement period.

Target date fund users are participants with at least 70% of their account balances 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.

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