

The Pension Protection Act and Automatic 401(k) Enrollment:

Opportunities and Challenges

Vivek Mehra, Director | Global Financial Services | Keane
Susobhan Mishra, Manager | Global Financial Services | Keane



Vivek Mehra



Susobhan Mishra

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There's no question that the popularity of defined contribution (DC) plans has increased over the last few years. In particular, 401(k) plans have become the choice retirement vehicle over traditional defined benefit (DB) plans. According to the Investment Company Institute, at the end of 2005, 401(k) plans witness approximately 47 million plan participants who had accumulated \$2.4 trillion in plan assets¹ — much ahead of assets in any other DC or DB plan. Although the total annual contribution level during the last 20 years has never matched its 1982 peak of \$45,475², total 401(k) assets have grown at a CAGR of 15.21%. While, 401(k) plans have gone through many regulatory and legislative changes since their initial regulation by the IRS in November 1981, The Pension Protection Act of 2006 aims to evolutionize the retirement services industry and encourage further 401(k) growth.

Automating 401(k) Enrollment

One aim of the hefty (900-plus-page) reform package is to encourage workers to save for retirement through defined contributions. One such provision of the Act mandates that plan providers automatically enroll employees into the company's 401(k) plans. While this feature is not new to the industry

(approximately 16.9% of plans in 2005 are already using automatic enrollment³), the PPA has given it new impetus. The PPA's automatic enrollment allows companies to set the default contribution at a certain percentage, say three percent of the employee's pay, and allows the participant to opt out.

The PPA also provides employers protection from state payroll withholding laws that would otherwise prevent them from instituting automatic enrollment. Under the law, an employer can automatically enroll employees in a 401(k) plan and set minimum contribution rates without their approval. This minimum applies when employees do not elect to make changes to their plans. Employees can change the employer's election or opt out of the plan within 90 days for a penalty-free return of automatic contributions. Although the Department of Labor is currently working on defining the guidelines for default investment levels, investment advisors will increasingly demand and influence the choice of plans for participants. There will also be clear demand for 401(k) plans offering lifecycle funds and an increase in the number of investment options.

Apart from legislative support, an important reason for the phenomenal

growth in participation rates of the 401(k) has been the plan's design aimed at meeting workers' needs, such as by allowing employer contribution and offering a variety of investment options. Post-PPA, the plan's success will depend on its flexibility and features, such as loan provisions, employers' matching contributions, vesting options, investment options, and model portfolios. To support all of these products and services, plan providers will need to assess and optimize the current defined contributions process, its supporting applications architecture, and the usability of end-user applications.

Optimizing Your Process Architecture

First and foremost, plan providers must place a strong emphasis on optimizing the 401(k) process architecture. This includes first assessing current steps and clarifying the roles and functions related to the business process. Process and hand-offs need to be identified, and redundancies removed. Functions such as changing contribution levels need to be automated as much as possible, eliminating manual, paper-based steps.

Redesigning Your Applications Architecture

Building or redesigning applications in order to cater to the needs of the new 401(k) plan landscape requires a careful assessment of the existing IT and business environment. To create functionality that is flexible and easy to maintain, and can change as business priorities do, plan providers should adopt a services-oriented architecture. Application functionality needs to be designed as discrete, loosely-coupled "services" that can be assembled to



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create higher-level functions. Plan providers will have to modify existing business rules and reports related to plan administration, recordkeeping, and employee communication in order to reflect the PPA rule changes. In addition, plan providers will have to assess existing data management to improve the quality of data around campaign and customer relationship management.

Improving the User Experience

To comply with the PPA, and to make sure participants do not opt out of the default enrollment, sponsors and administrators will need to focus on offering participants tools that make the investment selection process easier. This means placing a strong emphasis on online self-service capabilities. This will require creating more usable and interactive end-user interfaces using Rich Internet Technologies such as Flex and

Ajax. There also needs to be a strong emphasis on developing consistent information design, and enhancing self-service capabilities.

Although the automatic enrollment provision will be effective from January 2008, many plan providers have already started offering automated 401(k) enrollment and are gearing up to enhance process and technology architectures.

Keane recommends developing a comprehensive approach toward process, applications architecture, and user experience in order for plan providers to cater to the demands of a fast-growing participant base. Keane's PPA framework helps clients to assess their current architecture and develop a roadmap for PPA-specific initiatives that will be critical for plan providers to realize the opportunity presented by the Act.

Vivek Mehra is the director of Global Financial Services and Susobhan Mishra is the manager of Global Financial Services at Keane.

To find out more about Keane's PPA framework, call us at 1.617.517.1474 or email us at info@keane.com

SOURCES

1. Investment Company Institute, "401(k) Plans: A 25-Year Retrospective," Perspective, November 2006. <http://www.ici.org/statements/res/index.html>
2. Ibid
3. Ibid

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