Educating Pension Plan Participants

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Abstract

This paper discusses the use of educational programs by large employers to help employees make informed decisions in connection with their retirement plans. It examines the history and types of programs offered, their scope and objectives. It also explores whether there is adequate evidence that these programs increase the efficacy of retirement savings.

The first section provides a definition of employer-sponsored participant education programs. The second section describes the history of, and variations in, such programs and suggests an optimal program. The third section reviews studies on the impact of such programs on participant behavior and suggests a model for future program evaluations and research.

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What is Employer-sponsored Participant Education?

As noted by Olivia Mitchell and Sylvester Schieber: "(P)ension education is becoming increasingly important to sponsors of DC (defined contribution) plans. Participants vary according to the types of information they need and can process regarding investment risk, return and related issues. Examining alternative approaches to pension education reveals that the way pension education is presented can have a large impact on pension plan members' investment behavior." (Olivia S. Mitchell and Sylvester J. Schieber, eds., *Living with Defined Contribution Pension Plans*, Philadelphia: Pension Research Council and University of Pennsylvania Press, 1998: 11)

A practical definition of employer-sponsored participant education is a program that helps employees develop skills to make informed decisions and take action to improve their financial well-being. This definition incorporates the following key elements:

- Helps individuals based on their status as *employees* of an organization
- Provides recipients with *skill development*, which may include either new competencies or the enhancement of existing competencies
- Enables participants to make *decisions* about issues
- Provides a basis of accurate, unbiased *information* for such decisions
- Is *action*-oriented and thereby attempts to affect behavior
- Seeks the long-term result of *improved financial well-being*

What Types of Programs Have Employers Provided?

Employer-sponsored participant education programs are an outgrowth of pre-retirement planning programs that were offered by many large (i.e., at least 1,000 employees) employers in the 1980s. Pre-retirement planning programs were typically limited to employees who were within a few years of being able to retire under their employer's defined benefit pension plan. The primary goal of these programs was to help participants identify their basic retirement decisions and start planning for a relatively imminent departure from the workforce. The focus of pre-retirement planning programs was on projecting income sources in retirement (e.g., pension plans, savings plans, Social Security, personal investments, part-time employment), matching these to projected income needs, and deciding on a retirement date that seemed workable. The emphasis was on the financial side of retirement in general and on plan distribution options in particular. Some programs included small doses of non-financial concerns, such as health, housing, life adjustments, and other financial issues, such as estate planning.

Employers that offered pre-retirement planning seminars to employees, who were often able to participate with their spouses, reported that the most common reaction by participants was two-fold: first, that the seminar was one of the best "benefits" ever provided to them as employees; and second, that the employer should have provided a program much earlier in the employee's career when planning horizons were much longer.

The subsequent stimulus for employer-sponsored education for employees at younger ages was due to the enormous shift in retirement funding from defined benefit to defined contribution plans that took root in the 1980s. As 401(k) and similar DC plans became more prevalent and prominent, employees assumed more responsibility for making retirement financing decisions and living with the lifelong consequences. Some leading employers recognized the need to equip employees with tools and resources to meet this new responsibility.

Employee success in achieving financial security became part of the business of the human resource function, especially as its strategic focus turned to recruiting, retaining and motivating a committed, productive workforce and optimizing the deployment of human capital to enhance shareholder value.

While the scope of some employer educational efforts was broad and accompanied a life-events approach to benefits communications, most employer-sponsored education was narrowly focused on investing in company-sponsored 401(k) or other DC plans.

Participant investment education did not, however, achieve mainstream status until the U.S. Department of Labor issued guidelines under Section 404 (c) of ERISA. These guidelines, issued in 1992, clarified the "sufficient information" requirement for a plan sponsor to claim 404 (c) protection against participant claims due to investment losses in participant-directed accounts. In 1993, for example, the Institute for International Research sponsored a conference on "Designing and Implementing Investment Education Programs for 401(k) Plan Participants" in what was billed as "the first forum dealing with the most critical issue facing human resource, employee benefits and trust investment professionals."

In 1995, the U.S. Department of Labor launched a "national pension education program aimed at drawing the attention of American workers to the importance of taking personal responsibility for their retirement security." (Former Assistant Secretary of Labor Olena Berg, quoted in B. Douglas Bernheim, "Financial Literacy, Education and Retirement Saving," in Olivia S. Mitchell and Sylvester J. Schieber, eds., *Living with Defined Contribution Pension Plans,* Philadelphia: Pension Research Council and University of Pennsylvania Press, 1998: 38) At the time of this campaign, the theme of which was "Save! Your Retirement Clock is Ticking," there were estimates that 88 percent of large employers offered some form of financial education, more than two-thirds of which added these programs after 1990. (*Pensions and Investments.* "Employees Getting More: Investment Education, Planning Help on the Increase." January 23, 1995: 74, cited by Bernheim: 39)

In 1996, the Department of Labor gave further impetus to participant education when it issued Interpretive Bulletin 96-1, which distinguished such education from investment advice under ERISA. At that time, plan sponsors were extremely reluctant to cross the line and provide investment advice due to concerns over potential fiduciary liability. Today, however, some employers have concluded that the risk of offering advice is less than the risk of not offering it.

Surveys have been all over the lot when it comes to estimates of how many employers offer such advice. According to the Profit Sharing Council of America, 22 percent of its 141 member companies made investment advice available to plan participants in 2002. (Profit Sharing Council of America, February 2002)

Investment advice approaches fall into one of three categories.

Advice Directly from Plan Providers with Disclosures. The Retirement Security Advice Act, sponsored by Rep. John Boehner (R-Ohio), has passed the House of Representatives in each of the past three years. Although it has had the ongoing support of the Bush Administration, it has been unable to pass the Senate. Under this bill, a plan sponsor may authorize a plan provider to take on the role of investment advisor under ERISA. The advisor may be a provider or manager of plan investment funds, but must disclose to participants relevant fees and potential conflicts of interest. The provider would be able to give advice directly to participants without using independent sources of advice.

Advice from Plan Providers Using Independent Sources. The U.S. Department of Labor issued advisory opinion 2001-09A in December 2001 to SunAmerica, allowing a financial institution to offer advice to plan participants, but only if the source of the advice is independent of the institution as plan provider. This opinion also allows participants to delegate investment decisions to professional advisors who in effect take over the management of their 401(k) accounts. The opinion defines “independent” as receiving no more than 5 percent of revenues from a source related to the financial institution.

Advice from Independent Sources Only. The Independent Investment Advice Act, introduced by Sen. Jeff Bingaman (D-New Mexico), would protect plan sponsors who offer investment advice from liability, but only if the advice is given by independent firms that do not provide or manage plan funds. Similar legislation introduced by Sens. Edward Kennedy (D-Mass.) and John Kerry (D-Mass.) reflects this approach.

Until further action by Congress or the Labor Department, many plan sponsors have concerns about the extent to which they might be liable for losses with respect to investment advice they make available to participants.

The most recent federal initiative to promote financial education has come from the U.S. Treasury Department’s Office of Financial Education (OFE). In January 2004, it released the first issue of its on-line, quarterly newsletter, “The Treasury Financial Education Messenger.” The inaugural issue contains a message from Treasury Secretary John Snow stressing the importance of financial education and highlighting eight elements of a successful financial education program. (U.S. Department of the Treasury, Office of Financial Education, Washington, D.C, 2004)

Employee financial education programs have by and large been vaguely defined. Most surveys have accepted employer statements that they have such programs without subjecting such statements to independent scrutiny. For example, a Towers Perrin TP Track survey of 122 companies reported in August 2002 found that 33 percent educated their employees “constantly” about investments. Other respondents limited educational activities to plan enrollment periods (32 percent) or to employee requests (24 %). (Towers Perrin TP Track survey, reported in *Plan Sponsor.com,* August 2002)

Typical program deliverables include:

- Generic print (e.g., newsletters, guides, workbooks)
- Personalized print (e.g., individual benefit statements, retirement projections)
- Group learning (e.g., live workshops/seminars, on-line sessions)
- Individual learning (e.g., CDs, videotapes, audiotapes, Web-based self-study modules)
- Telephone counseling
- Face-to-face counseling
- Web-based tools

Few employers have made these programs such a priority that they established positions in their human resource or benefit functions that were devoted in whole or in part to education. One employer who did so was Xerox, which created the position of “Manager, Benefits Education.” (Barocas, Victor S., *The Conference Board.* “Benefit Communications: Enhancing the Employer’s Investment, 1993: 14)

Using an optimal definition – an employer-paid program available throughout the year during working hours and including education that is both custom-tailored to the employer’s specific benefit plans and individualized to each employee – I estimate, based on 25 years of experience consulting with employers on this topic, that no more than 20 percent of large employers can legitimately claim that they have such a program. The vast majority of participants in 401(k) plans remain in effect on their own when it comes to obtaining financial planning assistance.

What Impact Have Such Programs Had on Participant Behavior?

Meaningful evaluations of employee financial education activities should ideally establish what is to be measured as part of the research and planning phase of a program, occur throughout the program at certain milestones, assess changes in the actual impact of various educational activities over time, and utilize both quantitative and qualitative measures. Few if any programs have thus far been subject to this level of evaluation.

As noted by B. Douglas Bernheim: "Much of the evidence on the effects of retirement education in the workplace is derived from qualitative surveys and case studies." (B. Douglas Bernheim, "Financial Literacy, Education and Retirement Saving," in Olivia S. Mitchell and Sylvester J. Schieber, eds., *Living with Defined Contribution Pension Plans*, Philadelphia: Pension Research Council and University of Pennsylvania Press, 1998: 57) The few reported studies that have attempted to provide quantitative evidence of the effects of such education lack "detailed descriptions of program structure and content." (Bernheim: 57)

Furthermore, virtually all reported studies are based on participant statements of satisfaction with program deliverables, typically captured in questionnaires immediately following their participation, and expressions of intent to take action. No reported attempts have been made thus far to track actual changes in participant behavior as a result of participation in employer-sponsored education programs.

A successful program needs a baseline of data from which to measure progress. In view of technological advances in plan recordkeeping, more data on employee 401(k) and other benefit plan activities are now available to identify patterns that may have serious long-term retirement security consequences. Such data will be more meaningful if supplemented with qualitative assessments of different employee population segments. Sources of segmentation data are surveys, individual interviews and focus groups. Employees may be segmented in many different ways, including demographic cuts (e.g., age, years of service, gender, income, education), job (e.g., business unit, location, function, pay level), financial sophistication (e.g., basic financial literacy, interest in money management, investment savvy, retirement confidence) and learning styles (e.g., self-study vs. instructor-led, group learning vs. individual counseling, live vs. Web-based, text vs. graphics).

Overall, plan sponsors do not appear to be satisfied with their current employee financial education programs. According to a January 2004 survey by investment education provider ICC Plan Solutions, only 11.9 percent of plan sponsors said they were satisfied with their current programs, while 73.8 percent said that their participants needed help with basic investing knowledge.

Employers are also seeing evidence of increasing financial difficulties on the part of their employees through such vehicles as employee assistance programs. For example, according to a February 2004 release by ComPsych, a Chicago-based employee assistance provider covering about 25 million people worldwide, 40 percent of all work-life calls made by workers were related to financial help, up from 26 percent a year earlier,

Plan sponsors today seem most concerned with five patterns of participant behavior that run the risk of jeopardizing their future financial well-being. These are:

- Non-participation in plans
- Low rates of plan contributions
- Questionable investment allocations

- Loans
- Distributions upon termination

Participation

According to Fidelity Investments, the average participation rate in large 401(k) plans is approximately 70 percent. (Fidelity Investments, "Building Futures," Report IV, 2003) Recent studies have indicated a downward trend in participation rates. For example, Hewitt Associates reported that average plan participation in 2002 was 68.2 percent, which represented a decline of 2.8 percent across comparable plans. (Hewitt Associates. "How Well Are Employees Saving and Investing in 401(k) Plans," 2002)

A study using the Federal Reserve Board's 1998 Survey of Consumer Finances examined the factors that influence an employee's decision to participate in a 401(k) and how much to contribute to the plan. The authors found that, in addition to being positively associated with a worker's age, income, education, and length of service, participation was greater among employees whose planning horizon was four years or more. They interpreted this result to suggest that educating employees on the importance of planning for retirement could raise savings rates. This research indicated that the amounts employees contributed were positively related to employee income and wealth, long planning horizons, employer matching contributions, and the ability to borrow from the plan. (Alicia H. Munnell, A. Sunden, & C. Taylor, "What Determines 401(k) Participation and Contributions?" Working Paper 2000-12, Center for Retirement Research, Boston College, Chestnut Hill, MA, December 2000)

There have been attempts to measure the impact of employee education on plan participation. Clark and Schieber (Clark, Robert L. and Schieber, Sylvester J., "Rates and Contribution Levels in 401(k) Plans," in Olivia S. Mitchell and Sylvester J. Schieber, eds., *Living* *with Defined Contribution Pension Plans*, Philadelphia: Pension Research Council and University of Pennsylvania Press, 1998) considered various levels of plan communications, all of which involved the provision of written information (e.g., enrollment forms, statements of account balances, generic newsletters, custom-tailored materials). They found that "increasing the quality of communications significantly increases participation rates." For example, providing generic materials in addition to forms and statements increased the probability of participation by 15 percentage points. Using custom-tailored information increased the probability by another 21 percentage points over only providing forms and statements. To isolate the impact of such materials, the match rate was held constant. Indeed, one of their most important findings was that "improving communications concerning the plan has nearly as significant effect on the probability of participation as does increasing the match rate." They also found that "workers make current participation decisions based on education programs that were put in place by the firm at an earlier date."

A key determinant of impact is frequency. According to Bernheim: "While the provision of low-frequency education raises participation rates on average by 13 percentage points, high-frequency education increases this rate on average by 25 points." (Bernheim, op. cit., p. 63)

More recently, a study was conducted of one-hour financial education seminars provided by TIAA-CREF at educational institutions and other nonprofit organizations. As reported by Clark and d'Ambrosio, the study was based on surveys given to participants at the start, immediately after and three months following seminars. The first round of surveys covered 270 respondents. The primary behavioral focus of the study was on the impact of the seminar on participants' retirement goals, particularly their planned retirement age. The first round results found that nearly 10 percent stated that they had increased their retirement age and that nearly 18 percent decreased their retirement income objective. In addition, according to the study, "a high proportion of seminar participants indicate that they plan on being more active in determining their retirement savings." (Clark, Robert L. and Madeleine B. d'Ambrosio, "Financial Education and Retirement Savings," Society of Actuaries, San Francisco, CA, June 2002)

Contributions

According to the Profit Sharing Council of America's 46th Annual Survey of Profit Sharing and 401(k) Plans, 401(k) deferrals averaged 5.2 percent in 2002. Hewitt Associates, however, reported that the average contribution rate in 2002 was 7.8 percent. Even the higher rate, however, represents an inadequate contribution rate, especially by those participants for whom their 401(k) plan is the primary retirement funding vehicle and their only form of long-term savings. According to a January 2004 study by Prudential Financial, only 31 percent of today's workers report contributing the maximum allowed to their company's 401(k) plans.

Low plan contribution rates include failure to at least gain the full employer match on the one hand and limiting contributions only to matched dollars on the other.

Clark and Schieber also found that certain types of participant communications had a considerable positive impact on contribution rates. Specifically tailored plan information resulted in an increase in the annual contribution rate by two percentage points.

Investments

Many plan participants appear to be engaged in questionable investment behavior ranging from problematic asset allocation and failure to rebalance funds periodically to specific fund selections that indicate nondiversification of retirement assets in general and overconcentrations in employer stock in particular.

According to Fidelity Investments, one quarter of participants hold only one investment option in their 401(k) plan. (Fidelity Investments, op.cit.) According to Hewitt Associates, 41 percent of plan participants held only one or two funds in 2002. (Hewitt Associates, op. cit.) There is also some evidence of choice overload in plans leading to dubious participant decisions, including non-participation. (Iyengar, Sheena S., Wei Jang and Gur Huberman, "How Much Choice is Too Much: Contributions to 401(k) Retirement Plans," Pension Research Council, 2003)

According to the Employee Benefit Research Institute, over 8 million 401(k) participants hold more than 20 percent of their plan assets in company stock. (VanDerhei, Jack, EBRI, "The Role of Company Stock in 401(k) Plans," February, 13, 2002.) Hewitt has reported that company stock averaged 41.8 percent of balances among participants holding *any* company stock. (Hewitt Associates, op. cit.)

Investment advice providers have only recently begun to report on internal evaluations of participant use of their programs. The International Society of Certified Employee Benefit Specialists surveyed employers who provided advice to their employees and reported that 18% of participants shifted asset allocations as a result of their use of on-line advice services. Overall, however, 70 percent of employers either did not measure the impact or did not know. (International Society of Certified Employee Benefit Specialists, "New Kid on the Block: Financial Planning as an Employee Benefit," reported in *Employee Benefit Plan Review,* February 2002). None report using independent third party assessments.

Loans

A loan provision is a common feature in most 401(k) plans and approximately 20 percent of plan participants have outstanding loans at any one point in time. Few participants understand the true cost of loans and their negative impact on long-term retirement funding. No reported program evaluations have focused on this aspect of participant behavior.

Distributions

Many participants cash out lump sums upon termination of employment, instead of deferring distributions or rolling them over to individual retirement accounts or other employer plans. As a result, there is widespread “leakage” of retirement funds. No reported program evaluations have focused on this aspect of participant behavior.

A Future Model?

Working with the Employee Benefit Research Institute (EBRI), a large client of Ernst & Young’s employee financial education practice is in the process of an evaluation that will track actual employee 401(k) plan behavior and correlate changes in such behavior to employee participation in live workshops on saving, investing and retirement planning, employee viewing of a videotaped workshop, and employee use of an on-line modelling tool provided by another firm. The sample size will be approximately 25,000 participants. Specific participant behaviors being studied are changes in: participation in the employer’s 401(k) plan; 401(k) plan contribution rates; and plan investment selections. This type of quantitative evaluation of actual behavioral change by an independent third party may serve as a model for future program evaluations.

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