May 2019

Retirement Times

NEWS AND UPDATES FOR RETIREMENT PLAN SPONSORS AND FIDUCIARIES

Four Ways to Increase Employee Retirement Contributions

As a retirement plan sponsor, you want your employees to save the most they can in order to reach their maximum retirement potential. A significant amount of research says that you can improve both employee participation and their saving rates. Here are four ways you can help your employees start building a confident retirement:

1. Boost employee participation with automatic enrollment. Choosing to automatically enroll all new employees in your retirement plan can dramatically improve your participation rates. According to the Center for Retirement Research (CRR) at Boston College, in one study of automatic enrollment, participation increased by 50 percent, with the largest gains among younger and lower-paid employees.[1] While auto enrolled employees are allowed to opt out of the retirement plan, most generally stay enrolled.

2. Set the initial default contribution rate higher. Many companies who use auto enrollment set their default contribution rate relatively low at 3 percent, according to the CRR, which is lower than the typical employer match rate of 6 percent. Workers who might have contributed more to their savings passively accept the lower default rate, which means they're sacrificing employer matching funds along with saving less of their own pay.

3. Adopt auto escalation. Plans that use auto escalation automatically increase their participants' contribution rate every year, typically by 1 percent. Over time, that can significantly improve savings rates among workers. The CRR cites a 2013 study of Danish workers where the majority of workers who experienced automatic increases simply accepted them, and savings rates dramatically increased.

4. **Automate investment decisions with target date investment products.** Investing is complicated, and many employees don't want to take the time to learn how to manage their portfolios. Target date strategies automatically adjust an employee's investment allocations over time, shifting them to a more conservative asset mix as the target date (typically retirement) approaches. The ease of use of target date funds means their popularity is increasing. The CRR notes that in 2014, nearly 20 percent of all 401(k) assets were in target date funds, and about half of plan participants used target date funds. [2]

[1]http://crr.bc.edu/wp-content/uploads/2016/08/IB_16-15.pdf

[2]http://crr.bc.edu/wp-content/uploads/2017/01/IB_17-2.pdf

How Many Investment Options Should You Offer?

Many plan sponsors struggle with deciding how many investment options to offer in their retirement plans. While people generally like to have lots of options when making other decisions, having too many plan options can potentially lead to poor investment decisions by plan participants. In addition, increasing plan options can also increase plan costs, as well as the administrative paperwork associated with the plan.

In a study on retirement plan options, researchers concluded that it is possible to present plan participants with too many options.[1] The researchers began by offering people selections of jams and chocolates. Some were offered a wide variety, while others received less choices. The wide variety of jams attracted more attention from people, but more people purchased jams when offered limited choices. When sampling chocolates, people enjoyed choosing from the larger selection more, but also were more dissatisfied with the choices. Those who sampled from a smaller selection were more satisfied and more likely to buy chocolates again. In other words, as the number of options increased, people became more concerned by the possibility of making the "wrong" choice–they became uncertain that they had made the best choice possible.

Chocolates and jams aren't very big decisions, but the researchers found that these same behaviors carried over to retirement plans. They examined participation rates for 647 plans offered by the Vanguard Group, a large investment management company, covering more than 900,000 participants. They found that as plans increased the number of options they offered, employee participation decreased. In fact, for every 10 options added to the plan, participation dropped by 1.5-2 percent. Plans offering fewer than 10 options had significantly higher employee participation rates.

In addition, more plan options can increase costs both for participants, in the form of fees, and for plan sponsors, who may face additional administrative charges from third party administrators for additional options. Further, auditing and other costs may increase, since the number of options could increase the time necessary to conduct audits.

It's important to balance choice overload against the requirements of ERISA Section 404(c) which requires plan sponsors to have at least three diversified investment options with different risk and return characteristics.

[1]http://www.columbia.edu/~ss957/articles/How_Much_Choice_Is_Too_Much.pdf

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