401(k) Communication Challenges

401(k) plans, unfortunately, have not become effective replacements for defined benefit pensions.[1] The most likely cause for this reality is that the rates at which most participants contribute to their 401(k) accounts are inadequate to provide them with realistic chances of achieving financially secure and comfortable retirements.

Inadequate contribution rates have been attributed to workers ignoring their retirement planning. This so-called lack of engagement most likely results, however, from the participants' low level of financial literacy[2] combined with their distrust of recordkeepers. In fact, *"the majority of 401(k) participants do not feel that the information presented to them is in their best interest"*.[3]

Surveys have found that participants are not blind to this reality. Retirement insecurity—the inability to retire at a desired age while maintaining the accustomed standard of living—is a major cause of the financial stress that plagues 52% of American workers[4] and has caused 46% of these employees to say that they spend three hours or more a week addressing their financial issues rather than doing their jobs.[5] Thus, increasing numbers of employers are extending their health and well-being initiatives to include financial wellness hoping that their employees' productivity will be significantly improved.[6]

That "*retirement is the aspect of financial life in which individuals express the least confidence in their ability to manage and affects their productivity"*[7] should surprise no one. After all, *"only 57 percent of adult Americans know basic financial literacy concepts such as interest compounding, inflation, and risk diversification. And high school students* [America's future workers] *do no better… 18 percent of US students do not reach the baseline level of proficiency in financial literacy. Moreover, Millennials don't learn much about financial literacy after they leave high school…"* .[8]

Unfortunately, 401(k) plan communicators have not recognized that the participants' sense of distrust and their lack of knowledge can easily create a mindset that is conducive to inaction. Inaction, then, reflects a feeling of lack of control rather than lack of engagement. To make matters worse, 401(k) communicators have also discounted what participants have experienced during the last 16 years, including:

- the demise of their defined benefit pension plans;
- the "dot-com bust";
- the 2008 stock market crash that clobbered their 401(k) accounts and forced many of their colleagues to delay their retirements;
- job losses resulting from disruptive innovation and the moving of manufacturing operations overseas;
- frequent front page newspaper articles about extremely large executive bonuses and Wall Street scandals while they've experienced wage stagnation.

So how can 401(k) communicators attempt to "redeem" themselves and get participants to act in their own best interests? Perhaps rethinking the purpose and use of target-date funds could provide some useful insights.

Target-date funds are "sold" to participants via auto-enrollment, reenrollment, or "sales pitches" (brochures and/or employee education meetings). The use of these investment vehicles is equated with "one-stop shopping". Investment professionals create, monitor, and change a fund's asset allocation — stock/bond ratio — to reflect the number of years until the participant's projected retirement date is reached. Participants are told all they have to do is make contributions and keep their entire account balances in a single target-date fund.

How much should participants contribute to get or to stay on the road to retirement readiness? Participants are usually auto-enrolled (and occasionally re-enrolled) in these funds with a default contribution rate of between 3% and 6% of pay. In some cases, the participants will also be defaulted into an auto-escalation feature that will annually increase the contribution rate by 1% until the 10% level is reached. However, in 401(k) educational sessions, these participants are often told that they should be contributing at a level of between 12% and 15%. Neither plan sponsors nor communicators routinely evaluate how participants react to — how confused they get by — the conflict that exists between the sponsor's/communicator's actions (the default and auto-escalation rates) and their words ("contribute at 2 to 5 times the default rate").

A participant's confusion will likely be made even worse if the participant's spouse's or partner's 401(k) plan offers a target-date family with a significantly different glide path. One glide path could be a "to" type while the other could be of the "through" variety where the landing point is 15 years beyond the targeted retirement date. At the retirement date, it is quite likely that the "to" fund will have an equity allocation of around 40% while the "through" fund's equity allocation could be close to 60%.

For participants, this confusion may turn into bitter resentment if they recall, and many will, the unexpected losses of 2010 target-date funds in 2008. These funds' supposedly conservative asset allocations did not weather the 2008 Economic Crisis very well. Most of them lost over 20% of their value (equity allocations ranged from 65% to 26% as of late 2009)[9] and prevented many employees from retiring on schedule.

Until 401(k) communicators stop attempting to clothe target-date funds, and consequentially retirement readiness, with certainty, participants will put little faith in the value of their products. What is also surprising is that plan sponsors have allowed their providers to go on their merry way given the fact that *"only two in five* [plan sponsors] *think* [their participant communications and education] *programs are effective"*.[10]

Plan sponsors and their fiduciaries should insist that their recordkeepers and 401(k) communicators provide participants with gap analyses that show participants how many years they can expect to receive their targeted inflation-adjusted incomes at their current contribution rates. All the assumptions underlying these calculations, e.g., the targeted replacement ratio, pre- and post-retirement investment and inflation rates, projected Social Security benefits, salary growth rates, should be clearly stated and easy to see, i.e., not buried among legal disclosures all of which are in small print.

The reports should also tell participants that the assumptions used in calculating their current progress towards retirement readiness may differ from the assumptions shown on previous ones and there is also a good chance that, in the future, some of the assumptions will change again, possibly significantly. Participants must understand, and based upon their past experiences they probably do, that since today's economic conditions are in a state of constant flux, the assumptions are quite fragile. Only time will tell just how accurate (or inaccurate) today's assumptions turn out to be.

It is also important for communicators to have educational sessions that explain to participants why arriving at the assumptions involves a lot of crystal ball gazing and why, in spite of that fact, assumptions still have to be made. After all, without assumptions it is impossible to run the calculations that suggest what the current contribution rates should be or where the participants appear to be on the road to retirement security.

Building trust, and, consequently, increasing the participants' levels of engagement, requires confronting ambiguity head on. The consequences of ignoring ambiguity are clearly reflected in today's inadequate 401(k) contribution rate levels.

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[1] Ilana Boivie, *10 Years After the Pension Protection Act: Effects on DB and DC Plans*, National Institute of Retirement Security, 2016.
[2] Annamaria Lusardi, *Happy Financial Literacy Month!*, http://www.forbes.com/sites/pensionresearchcouncil/2016/04/01/happy-financial-literacy-month/#262c487a5308.
[3] Laurie Rowley, President NARPP, *Lack of Trust In Financial Institutions Has Reached Crisis Levels — For All Of Us*, https://medium.com/@NARPP/lack-of-trust-in-financial-institutions-has-reached-crisis-levels-for-all-of-us-eaef4df01b61#.afof6q73c.
[4] https://www.gobankingrates.com/personal-finance/financial-stress-state/.
[5] PwC's *Employee Financial Wellness Survey 2016 results*, p. 7-8.
[6] Jennifer Paterson, *Employee productivity top objective of global wellbeing programs: survey*, http://www.benefitscanada.com/benefits/healthwellness/ employeeproductivitytopobjectiveofglobalwellbeingprogramssurvey89632?Print.
[7] Voya, *Redefining Retirement Readiness*, 2015, p. 2.
[8] Annamaria Lusardi
[9] Morningstar's *Target-Date Series Research Paper: 2010 Industry Survey*, p. 9.
[10] American Century Investments, *Assumptions, Assessments and Actions: Plan Sponsor Views of Participant Support and Advisor Partnerships*, 2014, p. 5.