

# **Reinventing the Retirement Paradigm**

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## Chapter 9

### **Educating Pension Plan Participants**

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*William J. Arnone*

Individuals who do not understand financial mathematics, expected rates of return on investments, and the level of income needed to meet consumption expectations in retirement, are very likely to have considerably less retirement income than they desire. Better financial education is necessary if workers are to achieve their retirement objectives, and financial literacy is key to informed retirement saving decisions. A central issue worthy of debate is who should pay for financial education and how it should be provided.

A growing awareness of the need for pension education is partly due to the rise of defined contribution (DC) plans. As Mitchell and Schieber (1998) note, 'pension education is becoming increasingly important to sponsors of DC 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.' But education is also urgently needed for participants in defined benefit (DB) plans, as they must determine if their pensions are sufficient to meet retirement needs, or if they should contribute to supplemental retirement plans and save outside of tax-deferred plans.

It is my contention that firms and plan sponsors have an obligation to provide financial education in conjunction with their retirement plans. 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 in retirement. This definition incorporates: the responsibility to help individuals based on their status as employees of an organization; provide recipients with skill development, which may include either new competencies or the enhancement of existing competencies; enable participants to make decisions about issues; provide a basis of accurate, unbiased information for such decisions; take an action-oriented stance and thereby attempt to affect behavior; and seeks the long-term result of improved financial well-being.

### **What Types of Programs Have Employers Provided?**

Employer-sponsored education programs for plan participants 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 DB pension plan. The primary goal of these programs was to help employees identify their basic retirement goals and start planning for their 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 was consistent with this savings behavior.

The emphasis in such programs was on saving behavior and on payout options. Some programs included small components of nonfinancial concerns, such as health, housing, life adjustments, and other financial issues, such as estate planning. Employers that offered pre-retirement planning seminars to employees reported that the most common reactions by participants were that the seminars were one of the best 'benefits' ever provided to them as employees and that the employer should have provided similar programs much earlier in the employee's career when planning horizons were much longer.

Employer-sponsored education for employees at younger ages followed the significant shift from DB to DC plans that began to occur in the 1980s. As 401(k) and other DC plans became more prevalent, employees had to assume more responsibility for making retirement financing decisions. Some leading employers recognized the need to provide employees with the tools and resources to meet this new responsibility. Employee success in achieving financial security became an objective of human resource divisions of many large companies. These employers recognized the strategic importance of pension plans and quality educational programs in recruiting, retaining, and motivating a committed, productive workforce. While the scope of some employer educational efforts was broad and accompanied a life-events approach to benefits communications, most employer-sponsored education programs were narrowly focused on investing in company-sponsored 401(k) or other DC plans.

Participant investment education did not, however, achieve mainstream status until the US Department of Labor (USDOL) issued guidelines under Section 404 (c) of the Employee Retirement Income Security Act (ERISA) of 1974. 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 (IIR) 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' (IIR 1993).

In 1995, the USDOL launched a national pension education program with the objective of attracting workers' attention to the necessity of taking personal responsibility for their retirement security. This campaign featured the slogan 'Save! Your Retirement Clock is Ticking.' At this time, it was estimated that 88 percent of large employers offered some form of financial education, more than two-thirds of which added these programs after 1990 (Bernheim 1998). In 1996, the USDOL gave further impetus to participant education when it issued Interpretive Bulletin 96-1. This document clarified this type of education from investment advice as defined by the ERISA. At that time, plan sponsors were extremely concerned about crossing a legal line and being charged with providing investment advice. Today, many employers realize that the risk of offering advice may be less than the risk of not offering it.

Surveys vary widely in their estimates of the proportion of employers that offer financial education and advice. According to the Profit Sharing Council of America (PSCA) (2002), 22 percent of its 141 member companies made investment advice available to plan participants in 2002. Investment advice methods can be divided into three categories:

1. *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.
2. *Advice from Plan Providers Using Independent Sources.* USDOL 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.

3. *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 is taken by Congress or the USDOL, many plan sponsors have expressed concern 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 US Treasury Department's Office of Financial Education (OFE 2004). In January 2004, it released the first issue of its on-line, quarterly newsletter entitled *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.

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 of responding firms educated their employees 'constantly' about investments (Plan Sponsor.com August 2002). Other respondents limited educational activities to plan enrollment periods (32 percent) or to employee requests (24 percent). Typical program deliverables include generic print publications (e.g. newsletters, guides, workbooks); personalized print items (e.g. individual benefit statements, retirement projections); group learning settings (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, and web-based tools. Few employers to date have awarded these programs such a high priority that they established positions in their human resources or benefit functions devoted in whole or in part to education. One employer who did so was Xerox, which created the position of 'Manager, Benefits Education' (Barocas 1993).

Based on my experience, a high-quality employer-paid program should be available all year round, during employees' working hours, and it should include education both custom-tailored to an employer's specific benefit plans and individualized to each employee. To date, I estimate that fewer than one fifth of large employers have such a program. The vast majority of participants in 401(k) plans remain on their own, when it comes to obtaining financial planning assistance. This dearth of suitable financial education will become an increasing concern to employees, their employers, and to society.

## **What Impact Have Employer-Sponsored Financial Education Programs Had on Participant Behavior?**

Meaningful evaluations of employee financial education activities must clearly indicate the objectives of the program and how these goals can be measured. In addition, program evaluation will occur throughout the life of the program and at specific milestones. Good evaluation should also assess changes in the actual impact of various educational activities over time, utilizing both quantitative and qualitative measures. Few if any programs have been the subject of this level of evaluation to date. Given their expense, it is likely that employers will need to establish financial education programs, evaluate them carefully, and then amend the programs to successfully prepare workers for retirement.

In early work on this theme, Bernheim (1998) noted that a great deal of the evaluation evidence regarding workplace retirement education relies on qualitative surveys and case studies. The few that have attempted to provide quantitative evidence of the effects of such education lacked good descriptions of program structure and content. Furthermore, virtually all assessments of financial education programs have been based on participant statements of satisfaction with program deliverables. These responses have been typically obtained by questionnaires immediately following their participation, and are based on 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 data include 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. A recent survey by investment education provider ICC Plan Solutions found that 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, a Chicago-based employee assistance provider covering about 25 million people worldwide found that 40 percent of all work-life calls made by workers were related to financial help, up from 26 percent a year earlier.

Today many plan sponsors seem most concerned with five patterns of participant behavior that run the risk of jeopardizing their future financial well-being. These include: non-participation in pension plans; low rates of pension plan contribution; questionable investment allocations; high levels of loans from the pension accounts; and distributions upon termination. To each we address some brief comments.

**Participation.** The average participation rate in large 401(k) plans is approximately 70 percent, according to Fidelity Investments (2003). Not only is participation less than universal, but also there appears to be a downward trend in participation rates over time. For instance, Hewitt Associates (2002) reported that the average plan participation in 2002 was only 68.2 percent.

Several authors have tried to figure out what induces workers to participate in an offered 401(k) plan, and how much they contribute to the plan once they do participate. Munnell et al. (2000) 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. The authors interpreted this result to suggest that educating employees on the importance of planning for retirement would boost saving rates. That research also indicated that the amounts employees contributed were positively related to income and wealth, long planning horizons, employer matching contributions, and the ability to borrow from the plan.

There have been direct attempts to measure the impact of employee education on plan participation. Clark and Schieber (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 enhancing the quality of communications significantly boosted 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 had nearly as important impact on participation as did raising the employer match rate. They also found that workers tended to make their



participation decisions in response to education programs instituted some time earlier. A key determinant of education impact is apparently frequency. According to Bernheim (1998), low-frequency education enhanced plan participation by only about half the rate as high-frequency education.

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 (2002), surveys were given to seminar participants at the start, immediately after, and three months following the seminars. The primary behavioral focus of the research was to measure the impact of the seminar on participants' retirement goals, particularly their planned retirement ages. The first round of surveys covered 270 respondents, and results found that nearly 10 percent stated that they had increased their retirement age and nearly 18 percent decreased their retirement income objective. In addition, many seminar attendees said that they intended to become more active in saving for retirement thereafter.

**Contributions.** Evidence from a range of sources suggests that plan participants do not save at very high rates. For instance, the PSCA found that 401(k) deferrals averaged 5.2 percent in 2002, and Hewitt Associates reported an average contribution rate of 7.8 percent. Both represent inadequate contribution rates, especially by participants who rely on their 401(k) plan as the primary retirement funding vehicle and their only form of long-term saving. EBRI (1997) noted that fewer than one-third of workers reported contributing the maximum allowed to their company's 401(k) plan.

Low plan contribution rates also mean that many workers fail to earn the full employer match in many cases. In this light, Clark and Schieber (1998) reported 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 2 percentage points.

**Investments.** Many plan participants appear to be engaged in questionable investment behavior in their DC plans. These ranges from the failure to rebalance funds periodically, to fund selections that fail to diversify retirement assets in general and over investment in employer stock in particular. Fidelity Investments (2003) found in one survey that a quarter of DC plan participants held only a single investment asset in their 401(k) plans. Hewitt Associates (2002) notes that 41 percent of plan participants held only one or two funds in 2002. There is also some evidence of choice overload in plans leading to dubious participant decisions, including nonparticipation (Iyengar et al. 2004). Other data show that more than 8 million 401(k) participants held more than 20

percent of their plan assets in company stock (VanDerhei 2002). Overall, company stock still dominates many pension plan accounts, averaging 42 percent of balances among participants holding *any* company stock (Hewitt Associates 2002).

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 (ISCEBS) (2002) surveyed employers who provided advice to their employees and reported that 18 percent 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. None reported 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. Since loan features are often desired by workers, firms must carefully consider whether to include this option or restrict its use in an effort to increase retirement saving. The problem is that few participants appear to 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 in 401(k) plans take lump sums on terminating 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 and workers may have insufficient funds at retirement.

### **A New Policy Paradigm in Investment Education**

To date, there has been too little research on the effectiveness of the few programs that have arisen, though a new project is now underway. Working with the Employee Benefit Research Institute (EBRI), a client of Ernst & Young's employee financial education practice is initiating a means of tracking actual employee 401(k) plan behavior. The goal is to correlate changes in behavior and employee participation in live workshops on saving, investing, and retirement planning, employee viewing of a videotaped workshop, and employee use of an on-line modeling tool. With a sample size of some 25,000 participants, participant behaviors can be studied, including changes in plan participation, plan contribution rates, and plan investment selections.

This study, and others like it, is driven by the realization that more workers are being required to take greater responsibility for their own retirement saving than ever before. They will need more and better

financial education, and employers can help provide this, as long as it is reviewed, monitored, evaluated, and modified when needed. To date, most employers, even the very large ones, lack high-quality financial education programs supportive of their firm's retirement plans and policies. In the future, companies will need to evaluate how to allocate resources to educational programs so as to better prepare their employees for retirement.

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