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Is Defined-Contribution Plan Communication and Education Dead?

Now that plans can be automated to a large degree, do communication and education have roles to play? They do indeed. Getting workers into a 401(k) plan, increasing their savings rate, and improving their diversification through default mechanisms is not necessarily synonymous with financial security.

By Lori Lucas

At a global pension conference in Tokyo in fall 2007, Japanese plan sponsors—who are just beginning to grapple with defined-contribution plan issues—were seeking to learn from U.S. plan sponsors' decades of experience.

One question attendees asked: How much plan-related communication and education is enough? As we know in the U.S., the answer is not simple. Indeed, after examining the 2006 Pension Protection Act, it is possible to conclude that the Japanese plan sponsors may not have been asking the right question: Perhaps it's not how much communication and education is enough, but whether communication and education is useful when it comes to helping participants in defined-contribution plans reach their retirement income goals.

It's true that the Pension Protection Act is filled with disclosure and notification requirements and supports plan-sponsor provided advice for DC plan participants. However, the bulk of the act's regulation does not focus on communication and education. Instead, it is focused on automating plan features so participants in defined-contribution plans who do not take the time to plan for their own financial future can still benefit from the plan.

The act's support of automatic enrollment, contribution escalation and diversified default investment alternatives implies

that it might be better for the plan sponsor to simply place participants onto the appropriate financial path, rather than attempting to educate them in the hope that they will find the right path on their own.

There is no doubt that DC communication and education have shown their limitations:

- According to the 2007 EBRI Retirement Confidence Survey, while 73 percent of workers saving for retirement used written educational material they received from their employer or employer's retirement plan provider, only 15 percent found it the most helpful material in saving for retirement.
- Meanwhile, 42 percent of DC participants in a John Hancock survey indicated they have little or no investment knowledge. About 50 percent believe they possess the skills required to manage their portfolios, but would rather spend time doing other things.

Still, to conclude that automation in defined-contribution plans can or should supplant communication and education would be unfortunate. After all, getting workers into a 401(k) plan, increasing their savings rate, and improving their diversification through default mechanisms is not necessarily synonymous with financial security.

A recent study by Annamaria Lusardia of Dartmouth College and Olivia S. Mitchell of the University of Pennsylvania examined baby boomer retirement security and the

roles of planning, financial literacy and housing wealth.

The researchers found that those who report they undertook any planning—even “a little”—are much better off than those who said they planned “hardly at all,” according to the study.

In fact, the study found that people who engaged in even a small amount of planning were more prone to have sizable wealth holdings compared with those who had engaged in no planning.

What is “a little” financial planning? Psychological research shows that simply having subjects write down the specific steps they will take to implement a task can greatly increase follow-through. In other words, even engaging individuals at the most basic level when it comes to planning for retirement could improve the outcome.

Perhaps when it comes down to it, the right question to ask about defined-contribution communication and education is just this: What does the plan sponsor want to accomplish? If it is simply to increase plan participation, then automatic enrollment may be the right course of action.

But if the goal is to increase plan participation, and have participants value and appreciate the 401(k) plan, then communication and education can play an important role.

If the answer is to improve diversification, then diversified investment defaults may be sufficient.

But if the answer is to increase the potential for retirement income adequacy, then financial communication and education—at least according to the Lusardia and Mitchell study—may help.

The reality is that we have learned a lot about 401(k) communication and education in the past several decades. At least we've come far from the days when communication and education meant a 15-page color brochure that few took the time to read. So, in response to the basic question posed by the Japanese plan sponsors—what we do know about defined-contribution plan communication and education is the following:

Less is more. Simple one-page fliers have emerged as one of the most effective communication formats. This is especially true if they are focused on a single concept, are simple to understand and are easy to respond to. Plan sponsors have documented that one-page fliers asking employees to tear off and return a postage-paid response card so they

can participate in the DC plan typically yield a 15 percent to 20 percent response rate.

Communication must pave the way to action. Through research and experience, we have also learned that it is not enough to hold a financial seminar for employees in the hope that they will take action. The success of the financial seminar will greatly increase if workers can respond immediately—at the site of the seminar—to sign up for the plan, for example.

The employee may be a reluctant consumer. Frequently, it isn't that employees cannot understand the plan, but that they do not want to take the time to understand it. That's where lessons from marketing and advertising can come in handy. Targeted and personalized messages can grab the attention of reluctant consumers of the plan and create interest where none previously existed.

There is more than one type of employee. Given that the typical employee base consists of a spectrum of workers who

are diverse in such areas as age, gender and education levels, plan sponsors may wish to attack communication and education challenges from multiple angles, using a variety of communication channels. For example, some workers might respond well to a Web-based tool, whereas other workers may prefer more “high-touch” or paper-based communication approaches.

U.S. plan sponsors are fortunate to have the benefit of not only the Pension Protection Act's support of plan automation, but several decades of experience in communicating with and educating defined-contribution plan participants. The lessons learned during those decades haven't come easily, and they certainly should not be forgotten.

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