DCIIA
Defined Contribution Institutional Investment Association

Rethinking Defined Contribution Communication and Education

Plan Administration Committee

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The Defined Contribution Institutional Investment Association (DCIIA) believes that the current defined contribution retirement system, with the adoption of best practices, provides an excellent foundation for a secure retirement for working Americans. The important advances contained in the Pension Protection Act of 2006 (PPA)—particularly the safe harbor protections for plan automation and default investment selection—provide defined contribution (DC) plan sponsors with important plan design guidance and fiduciary safeguards. These enhancements support higher participation and savings rates, as well as more appropriate investment allocations for those not electing to actively participate. The current industry-led focus on retirement income should also lead to plan design improvements, further strengthening working Americans' ability to achieve a desired income replacement rate in retirement. By continually incorporating plan design best practices, DC plan sponsors can improve retirement savings outcomes, while managing their own fiduciary liabilities for plan governance.

Just as important as plan design, communication and education play pivotal roles in participant decision-making. The thoughts and suggestions contained in this paper are intended to be a first step in rethinking the way we approach retirement-savings communication and education. DCIIA hopes to encourage and facilitate a robust dialogue around ways we can work together to more effectively communicate with, and educate, the millions of Americans who rely on defined contribution retirement savings plans to fund their retirement security needs. These suggestions, when applied, can better engage participants and also create more positive retirement savings outcomes.

Benefit Awareness

Employees are frequently found to be unaware of the scope of their company-provided benefits, and of how theirs compare to other companies' benefits programs. In one study, at least 31 percent of the respondents failed to identify the quality of their benefits, or to understand how their benefits stack up in comparison to those in their industry peer group.[1] This strikes us as a significant missed opportunity for both the employees and the plan sponsor, potentially yielding a lower return on the employer's investment in its benefit programs and an un(der)realized benefit in the retirement accounts of its employee-participants. The good news is that, as the DCIIA Plan Sponsor Survey 2012 shows, while increasing participant savings rates is the first or second top priority for nearly half of the plan sponsors, improving communication and education efforts is the next highest priority for almost one-third of the participating plan sponsors.

Communicating the benefits of a retirement plan (many of which are intangible and long-term) is not easy, however. In order for employees to make decisions about their plan—decisions that will have life-long effects on their financial well-being—they need to understand not only the plan, but also their long-term financial needs. Doing so involves an appreciation of the answers to questions such as: how long they hope to or may realistically expect to work; what kind of lifestyle and expenses they anticipate having during retirement; and even how long they may live. We ask employees to consider "retirement" as a goal, as if it were a well-defined and universal concept. We find, however, that not everyone has the same definition of "retirement".

Framing: The Unintended Consequence of Communication

Participant decision-making is also susceptible to the "framing effect." As one example, plan participants tend to look to others for guidance as to how much they should be saving, and often choose what their employer's matching program "says" is the "right" deferral rate. Thus, the way the match itself is communicated can determine the deferral levels the participants select. For example, an employer matching $0.50 for every $1.00 deferred, up to a maximum of 3 percent of salary, may, through framing, be "telling" participants that up to a maximum of 6 percent is the "right" savings rate. Research shows, however, that employers often set their matching contribution rates to be competitive with benefits offered by other employers, rather than to nudge participants toward an appropriate savings rates for their individual retirement goals.[2]

Left Brain vs. Right Brain

Too often emotion and learned behavior play a big role in plan participants' saving and investing decisions. These financial decisions are closely tied to their (often unarticulated) gut feelings about risk, expectations for the future, delayed gratification and the end of life. According to the Boston Research Group (BRG), participants switch from their logical, fact-driven "left brain" to their more intuitive and subjective "right brain" when making such decisions. Often, however, decisions based on intuition are suboptimal when saving and investing for retirement. In participant focus groups conducted by the BRG between 2004 and 2005, they observed that participants use emotions to choose investment lineups—and often cite rules of thumb, or advice from family or friends. Most of the time, this choice methodology is at odds with financial guidance on asset allocation, which often uses risk metrics and "glide paths" to change investment holdings over time. Some participants do eventually try to "borrow" a left brain in order to make these harder long-term financial decisions. They may, for example, seek advice and guidance from human resources staff, coworkers, friends, family and financial advisors.

Apathy and Empathy

Those employees who do not participate in their company's plan, or who participate with very low deferral rates, may not sufficiently appreciate the future financial hurdles they are likely to face in retirement. It can be difficult to convince 20-year-olds that they need to set aside some of their salary to provide for future retirement needs when car payments, rent and concert tickets are front-of-mind. Even so, the task of helping participants create a sense of empathy for their future selves—along with creating a sense of the need to act—falls to the DC industry and plan sponsors in their communications programs.

Steps to Improve Retirement Benefits Communications

So how can plan sponsors do a better job of reaching employees, communicating the advantages of a DC plan or any employee benefits program? Knowing how employees think about their benefits and what triggers them to learn more about a benefit is crucial to effective communication. Recognizing what vocabulary employees understand and how they organize their thinking is critically important.

1. Don't Assume Your Participants are as Passionate as You are

Let's begin with ourselves: the educators, plan sponsors and industry stakeholders. We often suffer from what is called "assumed exuberance"; in other words, we don't know what it is like to not care about financial subjects that are important to us. In the area of DC plan education support, we design research tools and calculators with the implicit assumption that employees care as much about their retirement as the other issues in their lives that require them to focus, assimilate information and make rational decisions. Instead, preparing for retirement can take a back seat to more immediate financial concerns, such as current bills for rent or a mortgage, car payment and child-care costs. Future needs are often put off in favor of these more immediate ones. Until employees see retirement planning as a current need, they may not spend the time to learn, to invest the mental energy to plan for retirement, or to make informed savings and investing decisions.

- Communications need to be more focused on why employees should be "exuberant" about retirement today. Today's communications programs often assume that the employees are already engaged, but most are not. In a recent survey, 74 percent of plan participants selected "show me with clear examples how what I save today will pay off in the future" as the most likely strategy to help them save more for retirement.[3]

2. Use Simplistic Terms in Benefits Communications

Benefits communications may also inadvertently assume that participants know more than they actually do. If we look at nearly any participant-education material for DC plans, we find that communications assume the participants already have a certain understanding of the complex concepts and vocabulary that form the basis of a DC plan. Participant materials may expect employees to: understand unfamiliar concepts explained in an unfamiliar language, translate these concepts into strategic plans, and take action. Tellingly, "With the benefit of hindsight, retirees are much more in favor of a proactive plan sponsor role. In fact, 91 percent of retirees agree that plan sponsors should educate participants about the reality of longevity in retirement and 90 percent agree that plan sponsors should help participants understand their financial requirements in retirement."[4]

- Communication and education materials should strive to use terms that all participants can understand and should avoid industry jargon. When discussing specific funds, for example, consider using a broad asset-class nomenclature, as opposed to highlighting retail-fund names.

3. Aim to Improve Participants' Financial Literacy

It is assumed that improving financial literacy is a key component of improving decision-making. However, it is important to differentiate between financial and investment literacy. Financial literacy is the understanding of key financial decisions as they relate to retirement, such as income replacement rates or the very question of participation in a tax-qualified retirement savings vehicle. Investment literacy, on the other hand, is the understanding of key investment concepts such as the effects of interest rates on bond prices. Investment literacy is helpful, but it alone is not enough to change behaviors. Enormous resources have been devoted to improving investment literacy in the workplace, yet it remains difficult to prove that the resources spent on education have moved the needle with respect to financial or investment literacy. In examining Employee Benefit Research Institute (EBRI) data[5], we found that participants have invested in relatively the same manner over the past 20 years. It also appears that the lack of action taken by plan participants has remained relatively constant over time; for example, they have routinely failed to regularly reallocate their holdings. They often hold substantial equity or fixed-income allocations and, when available, may allocate significantly to company stock. Motivating people to change their investing behaviors by educating them about investment concepts such as diversification, asset classes and asset allocation has proven to be a challenge.

- To maximize the benefit of scarce communications resources, focus participants on the need, the why—and the benefit of—participating in a savings plan, and of using the tools available to help them with savings and investing decisions. In other words, focus on financial literacy over investment literacy.

- Additionally, education on a plan's automatic features, such as automatic enrollment and automatic contribution escalation, may serve as a building block with respect to financial literacy. DCIIA's white paper entitled "Best Practices When Implementing Auto Features in DC Plans" has more information on how automatic features can be structured to improve retirement outcomes for participants.

4. Take Advantage of Participants' Inflection Points

Improvement in the general level of financial literacy, and corresponding behavioral changes, tend to occur around major "inflection points" in participants' lives. Inflection points include: getting married, getting divorced, having a child, enduring long-term unemployment, experiencing a death in the family, reaping a windfall, approaching retirement, etc. These are events that change lives and financial needs, thus creating a sense of immediacy.

- Consider revising communication strategies by organizing benefits information around inflection points in participants' lives. For example, a critical inflection point is beginning a new job. The 56 percent of respondents to a recent survey who found it "easy" to get started in their DC plan were introduced to their retirement benefits through their employee orientation, and most indicated that it was easy to take action (e.g. enroll, select savings rates, select investments).[6]

5. Evolve Toward Modular Communication and Education

A final problem with traditional education is that it may assume that all employees want to know everything there is to know about their benefits all at once. This may not be the case.

When you go to pick up your new car, do you sit at the dealership and commit the entire owner's manual to memory before driving away? Generally, the answer is no, because you are excited to start enjoying your new car, not to learn how to change the tire at some point in the future. Say that a year after you purchased your car, you get a flat tire. At that point, you usually dig out the owner's manual, learn how to change the tire, and fix it. At that moment, your "tire-fixing" literacy has peaked. As the flat tire drifts into memory, your tire-fixing knowledge also quickly deteriorates. If, a year later, another flat occurs, you have probably forgotten exactly how to fix the tire, and have only a vague recall of the process. Out comes the manual again, and your tire-fixing literacy spikes once more.

If we apply this example to making decisions about DC plan benefits, it would make sense to approach benefits communication in a similar manner – modular and inflection-based. The implication of this strategy is that we may be able to better engage participants by shifting retirement planning to the forefront when it is most relevant to the participant. Relevance may then depend on each participant and his or her life inflection points. As a prominent economist stated, "We are finding that timing of education is really important. When people are looking for answers, you have to deliver the appropriate education. For example, you can't start talking to people in their 20s about withdrawal options at age 65."[7]

- Consider arranging communications around relevant modular topics and expected inflection points for participants.

Key Points and Conclusions

Benefits communicators should consider the following when revisiting their communication and education strategy:

1. The term "retirement" may not be a universally shared concept among plan participants. For example, do participants in your company view

retirement as a full stop to employment, or do they favor a phased approach to retirement? A plan sponsor can add value in end-of-career employment decisions. Plan sponsors should also consider a "whole of life" approach to benefits and employment pre-retirement counseling. Today, leading plan sponsors are using community-based programs to help connect pre-retirees to post-employment opportunities; they are adding phased retirement as an employment option, and post-retirement contracting and mentorship programs.

2. A plan's basic design and its framing can influence participant deferrals. Communicators should consider the intent of plan design and have a corresponding discussion of matching rates, investment options, savings rates and income planning in conjunction with other benefits.

3. Participants may need access to an investment advisor for help in left-brain decision-making. Although this is the role of plan design, if such services also exist within the plan, the communicator can help guide participants towards a left-brain decision-making framework.

4. There will be opportunities to make retirement planning a "current" priority for participants. Communicators should strive to turn life's inflection points into occasions to convey appropriate benefits during that life event.

5. The effect of investment education on participants' behavior has proven to be limited. How can we best use valuable time and space in benefits materials to teach basic financial literacy? We propose that time and resources should be spent on the "ends" of retirement: enrolling participants into the plan; helping them target appropriate savings rates; directing them toward a left-brain decision-making framework. Thus the focus should be on financial over investment education.

When plan sponsors consider the above points and make relevant plan changes, retirement communications can be improved from the typical stand-alone brochure to a more modular and inflection-based design. Organizing benefits around life's inflection points can transform how sponsors and their service providers communicate with participants—ultimately moving toward whole-of-life benefits communications.

ENDNOTES:

1 *Proprietary research, Boston Research Group Study, April 2012.*

2 *Proprietary research, Boston Research Group Study, February 2012.*

3 *Ingrid Maltrud, "Entrances, exits, and in-between," The Participant, State Street Global Advisors, Winter/Spring 2013.*

4 *Annual Retirement Survey: What Retirees Have to Tell Us about the New World of Retirement. BlackRock, 2012.*

5 *Employee Benefit Research Institute (EBRI). Analysis of EBRI data from 1998 to 2011 indicates that participants continue to have relatively constant exposure to extreme equity or fixed-income holdings.*

6 *Maltrud, op. cit., pp. 4–11.*

7 *Aaron Borders, "The Future of Life Cycle Saving and Investing," DC Dimensions, Dimensional Fund Advisors, Summer 2013.*

DCIIA RESOURCES: (WWW.DCIAA.ORG)

Best Practices When Implementing Auto Features in DC Plans, June 2013.

Plan Sponsor Survey 2012: Action Needed to Drive Better Participant Outcomes, December 2012.

ABOUT DCIIA:

The Defined Contribution Institutional Investment Association (DCIIA) is a non-profit association dedicated to enhancing the retirement security of American workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution plan design. DCIIA members include investment managers, consultants, law firms, record keepers, insurance companies, plan sponsors and others committed to the best interests of plan participants. For more information, contact www.dciia.org.