NFP™ Benefits
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Courageous Plan Design

Readying Employees for Retirement Through Bold Leadership

Introduction

Enormous resources are going toward encouraging employees to participate in their employer's 401(k) plan. After all, if the benefits are made clear and it's easy to enroll, who wouldn't take full advantage? Yet three decades after the 401(k)'s debut, employees still contribute too little to their plan or not at all, leaving them ill-prepared for retirement. *Why?*

The problem isn't education, access or, as some claim, a "broken" system. It's, in a word, *inertia.* Employees struggle to act in their own best interests even when they know it could improve their financial future. *That's why employers need to ensure that it takes less effort to succeed at saving for retirement than to fail.* The way to do that is with courageous plan design.

In traditional 401(k) plan design, employees must take several steps to begin saving: enroll, review investment options, choose a salary deferral rate, select an allocation mix and more. To not save, all they have to do is, well, nothing. It's obvious which is easier. Courageous plan design flips the paradigm, shifting the initial decision-making responsibilities back to employers that recognize their central role in workers' retirement readiness.

Capitalizing on inertia's doggedness, courageous plan design embraces automatic features that force employees to take action to opt out of a 401(k) instead of in. Aggressive automatic deferral rates and automatic contribution rate escalation (auto escalation) replace standard plan recommendations, and participation longevity is encouraged through generous matches and the opportunity to diversify tax strategies. These and other forward-thinking plan elements, including stringent savings leak prevention and simplified investing options, can position employees for long-term financial stability — and provide companies an even greater opportunity to succeed.

Courageous 401(k) Plan Design

- Automatic enrollment of new and existing employees with a 6 percent – or higher – default contribution rate
- Automatic 2 percent escalation of the default contribution rate each year, with no cap
- An approved qualified default investment alternative
- A generous and creative matching program
- A Roth 401(k) option
- No plan loan or hardship withdrawal options
- Limited investment options
- Exclude company stock

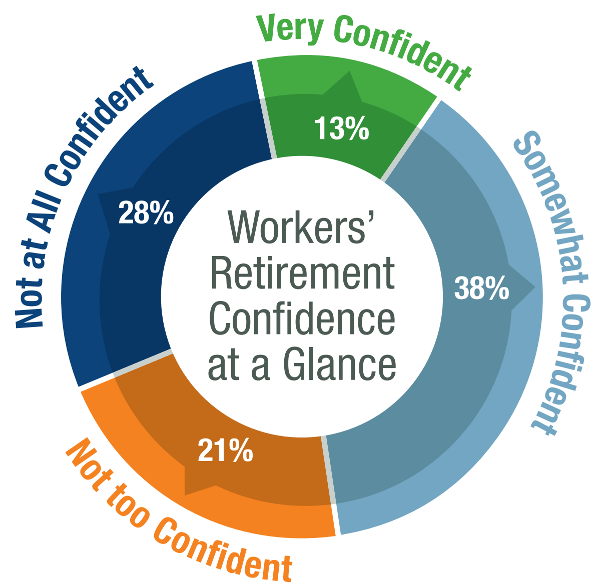
Helping Employees Help Themselves

Only 13 percent of workers are "very confident" they'll have enough money to live comfortably in retirement, according to the Employee Benefit Research Institute's (EBRI) 2013 retirement confidence survey.[1] The fact that the same survey reveals only 2 percent of workers identify saving or planning for retirement as the most pressing financial issue facing most Americans today isn't just saying something; it's screaming it: Employers need to have the courage to step back into the retirement readiness equation.

In the 1980s, our nation began moving away from pension strategies controlled by employers to 401(k) plans that place savings decisions squarely on employees' shoulders. During that transition, an unanticipated problem emerged. Despite nearly $1 billion spent each year on investment education and support, plan participants often make poor and uninformed decisions. The most problematic? The decision to do little or nothing.[2]

Behavioral finance, which examines investment decisions through the lens of psychology, points to reasons such as loss aversion, procrastination and a lack of investor discipline. Workers cite financial concerns more immediate than retirement, with EBRI's study finding that cost of living and day-to-day expenses top the list of reasons they don't contribute or contribute too little to their employer's plan.[3] In addition, 55 percent of those workers say they struggle with debt. Regardless of the rationale, relegating retirement savings to the back burner shouldn't be an easy option. A courageous plan design that hinges on automatic features, including automatic enrollment and automatic escalation of deferral rates, ensures it isn't.

Studies show that the contribution rate is the most significant factor in the size of an employee's final account balance, even more than investment selection or asset allocation.[4] By automatically enrolling employees at a significant deferral rate (with the ability to opt out or change set contribution amounts, which many employees lack the momentum to do) automatic features are driving higher participation and deferral rates, according to employers.[5]



Source: "The 2013 Retirement Confidence Survey: Perceived Savings Needs Outpace Reality for Many." Employee Benefit Research Institute Issue Brief, No. 384. March 2013.

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The reality is that no matter how a plan is designed, employees are being steered in some direction. Automation steers them onto a path of saving for their retirement.

The Proven Power of Automatic Features

Despite the success that early adopters have found with automatic features, some employers are uncomfortable with the notion that this progressive plan design means being paternalistic. They question if it's their role to "coerce" employees to act in a certain way. The reality is that no matter how a plan is designed, employees are being steered in *some* direction. Automation steers them onto a path of saving for their retirement while still giving them the freedom to make their own choices should they decide a different option is best. Avoiding automation, in effect, simply defaults employees to a savings rate of 0 percent, sending a message that their ability to comfortably retire on time is of little concern to their employer.

Automatic Enrollment

Automatic enrollment empowers employers to act in their employees' best interests by setting them up to build retirement savings with pretax employee contributions. The Pension Protection Act of 2006 (PPA) threw open the door to automatic enrollment, permitting an employer to automatically deduct deferrals from an employee's wages unless the employee actively elects to cease contributions or contribute a different amount. While auto enrollment was possible prior to PPA, employers were tremendously reluctant to use it until the act addressed liability concerns pertaining to deducting contributions without prior approval and making investment choices without participant direction.

Automatic enrollment by itself doesn't constitute courageous plan design.

By 2011, 56 percent of plan sponsors automatically enrolled employees, compared to 14 percent in 2003, according to an article by Shlomo Benartzi and Richard Thaler.[6] Opt-out rates averaged only 10 percent. Extensive research shows that there's little question this feature boosts enrollment, with one study showing that 70 percent of companies find it "Extremely/Very successful" in offering participants better investment performance than they would achieve on their own.[7] This finding is supported by the fact that employers that added automatic enrollment increased their participation rates from 69 percent to 81 percent — an increase of 12 percentage points.[8]

Despite its positive influence on plan participation, automatic enrollment by itself doesn't constitute courageous plan design. Recently, the feature faced a sharp backlash as research began to show that it can actually result in less savings for an employee. For example, a recent study found that participants who were automatically enrolled into a 401(k) contributed, on average, 1 percent less than participants who actively enrolled.[9] Over time, that seemingly small number can make a large difference in retirement savings accumulated.

The feature, however, isn't the culprit; the automatic deferral rate an employer chooses to set is the real issue. Once the rate is set, the same inertia that keeps employees from enrolling on their own keeps them from raising it, which they should over time. About three-quarters of plans that use automatic enrollment set employees' initial saving rate at just 3 percent of income.[10] The idea of 3 percent – which won't generate sufficient retirement savings for most employees – is based on the starting point set out in PPA as well as on the concern that employees will scoff at anything higher and actually opt out of the plan.

In reality, when employers use a 6 percent rate versus 3 percent, *there's very little increase in the opt-out rate.*[11] That's a critical point because placing the default saving rate at 6 percent significantly increases the chance for both low- *and* high-income workers to successfully achieve retirement adequacy, according to an EBRI study that defines "success" as an 80 percent replacement income ratio.[12] *(See illustration below)*

But in courageous plan design, 6 percent is just the starting point. To continue to guide employees toward a sound retirement once they're in a 401(k) plan, the next essential step is implementing auto escalation.

Auto Escalation

Auto escalation, annually increasing the automatic deferral rate, is arguably one of the most powerful tools employers have to bolster employee retirement readiness. This plan design feature, offered by 51 percent of U.S. employers,[13] can help more employees reach the oft-recommended 10 percent deferral rate within a reasonable amount of time. Plans with automatic escalation report average deferral rates of 8 percent or higher compared to the average deferral rates of 4 percent or less for the majority of plans in America.[14]

Research is finding that, in general, employees aren't opting out of automatic escalation. One recent survey found that more than two-thirds of plans with automatic escalation have opt-out rates lower than 10 percent, and half have opt-out rates less than 5 percent.[15] The most common automatic escalation is 1 percent per year until the participant reaches a total of 10 percent, which is consistent with PPA requirements for safe harbor plans. A 2013 survey of 401(k) trends found that 97 percent of companies using auto escalation increase the default at this rate.[16]

Courageous plan design raises the bar to a 2 percent increase per year, thus reducing the time it takes for participants to reach higher contribution rates. It is also recommended to not cap the increase at 10 percent, effectively allowing the participant contributions to increase until they reach their salary deferral limit (for 2014, the lesser of $17,500 or 100 percent of income, or $23,000 if age 50 or older).

Source: "Increasing Default Deferral Rates in Automatic Enrollment 401(k) Plans: The Impact on Retirement Savings Success in Plans with Automatic Escalation." Jack L. VanDerhei, Ph.D. Employee Benefit Research Institute, Notes, Vol. 33., No. 9. September 2012.

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It should be noted that employers that want their plan to qualify for the nondiscrimination testing safe harbor cannot have auto contribution escalation caps higher than 10 percent. Nondiscrimination testing ensures that a plan doesn't disproportionately favor highly compensated employees compared to rank-and-file employees. Safe harbor plans, which must follow specific guidelines, are generally exempt from certain nondiscrimination tests, and highly compensated employees can defer up to the maximum contribution limit. However, depending on the demographics of the plan, the need for safe harbor qualification may be reduced or eliminated by enacting automatic features. Also, if demographics do dictate that safe harbor qualification is beneficial initially, your plan advisor can help you create a strategy for reassessing the situation in coming years to determine whether removing the 10 percent cap has become feasible.

More aggressive escalation may seem unreasonable to companies already fearful that employees will respond negatively to any amount of automatic intervention. However, potential 401(k) program participants demonstrated the same response to 2 percent automatic escalation as they did to 1 percent escalation, according to Benartzi.[17]

Conversely, if participants are offered the choice of actively signing up for annual escalation, they're unlikely to do so. In fact, according to some research, only 8 percent will.[18]

Ideally, contribution escalations will occur at the same time as salary increases so that participants don't see a decrease in take-home pay. While raises are not always possible for a variety of reasons, including the company's financial health and individual employee performance, companies should leave escalation in place and allow employees to make the decision to adjust it.

To Sweep or Not to Sweep?

Courageous plan design includes a full sweep of all existing employees into automatic features. Implementing the features only for new hires doesn't create nearly as significant of an impact and sends a clear message to existing employees: You're not as valuable.

If your plan advisor properly analyzed your exposure assuming 100 percent participation and applying your current employer contribution and match strategy, you should already be prepared for the costs of implementing courageous plan design. If you plan on improving your contribution/match, an advisor skilled in plan design can work with you to minimize potential cost increases.

Qualified Default Investment Alternatives: QDIAs

Despite PPA, employers remain concerned about the fiduciary liability they could potentially face when choosing investments for employees who don't select their own. This liability can be reduced by directing these employees into qualified default investment alternatives (QDIAs) that are designed to minimize loss risk while providing long-term growth potential.

Regardless of why an employee fails to designate investment elections, a QDIA allows an employee a reasonably appropriate investment vehicle and significantly limits the employer's fiduciary liability for any 401(k) plan losses that result from the QDIA. Employers must, of course, follow the U.S. Department of Labor's (DOL's) QDIA guidelines, including the required notification, to obtain liability relief.

There are four types of approved QDIAs:[19]

- A product with a mix of investments that takes into account the individual's age or retirement date (For example, a life-cycle or target-date fund)
- An investment model that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (for example, a professionally managed account)
- A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (for example, a balanced fund)
- A capital preservation product for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration if it is common for their workers to opt out of participation)

An experienced plan advisor can help you choose smart investments that meet QDIA guidelines.

97 percent of plan sponsors that embraced automatic enrollment, automatic escalation and QDIAs together say the advantages outweigh any perceived disadvantages, indicating the value of the bundled approach compared to a single-feature approach.[20]

Are Automatic Features Right for Your Organization?

Talk to your plan advisor about how your organization can take advantage of automatic features. Fill out this checklist to start the conversation. More responses in the "Yes" column increase the potential suitability of automatic features.

Answer the following questions to determine if automatic features might be right for your organization.	YES	NO
Turnover: Is employee turnover relatively low?		
Lower turnover will likely enhance the benefits of automatic features. Higher turnover may result in large numbers of terminated employees with low balances.		
Participation: Is plan participation relatively low, taking into consideration employee demographics and industry?		
For most plans, a participation rate below 80 percent means that automatic enrollment will likely result in meaningful increases. Plans with higher participation rates may decide that other automatic features may be more efficient and/or effective in helping employees increase their retirement readiness.		
Working Status: Are most employees full-time, common-law employees (i.e., few or no leased employees, seasonal or transient workers, etc.)?		
Full-time employees are generally more likely to look favorably on plan participation than are other worker groups. Consider whether the benefits of offering auto-features to various employee groups will offset the administrative burdens.		
Average Salary: Is the average salary relatively high, and is the percentage of low earners (below $30,000) relatively low?		
Lower salary earners may be more likely to opt out of the plan.		
Contribution Rates: Has careful consideration been given to the existing plan dynamics?		
To maintain a plan's average contribution rate, the default contribution rate should be close to the average contribution rate or at least close to the maximum employer matching contribution, if any. Automatic escalation, preferably at 2 percent a year, could help employees reach their retirement income goals sooner.		
Compliance Testing: Has your organization had difficulty passing ADP or ACP testing, or has it been required to take corrective actions (either by making refunds or providing a qualified non-elective contribution to certain employees)?		
Automatic enrollment will likely result in increased plan participation, and therefore may reduce or even eliminate the need for corrective actions.		

Information provided by Transamerica Retirement Solutions.

Employee Communication is critical

- Required notice and standard automatic enrollment communication must be sent at eligibility or plan-entry date (e.g., automatic enrollment newsletter).
- In-depth participant communications and interactions should ideally begin six to 12 months after enrollment and focus on optimizing the plan's benefits.
- With automatic enrollment, the communication shifts from "why you should save" to "why you should save more." Direct email communication will enhance efforts to help participants optimize their savings.

Employer Contribution Match

A generous employer contribution match acts as a powerful supplement to automatic features and encourages employees to remain enrolled. In addition, if a company is in the rare position of being unable to implement automatic features, a match is a very effective participation enticement. A 2013 Plan Sponsor Council of America survey of 686 plans with 10.3 million participants found that plans with no matching company contribution only had 77.7 percent of eligible employees contribute, while plans with a graded company match (one that varies depending upon the level of employee contribution) saw an 84.4 percent contribution rate.[21]

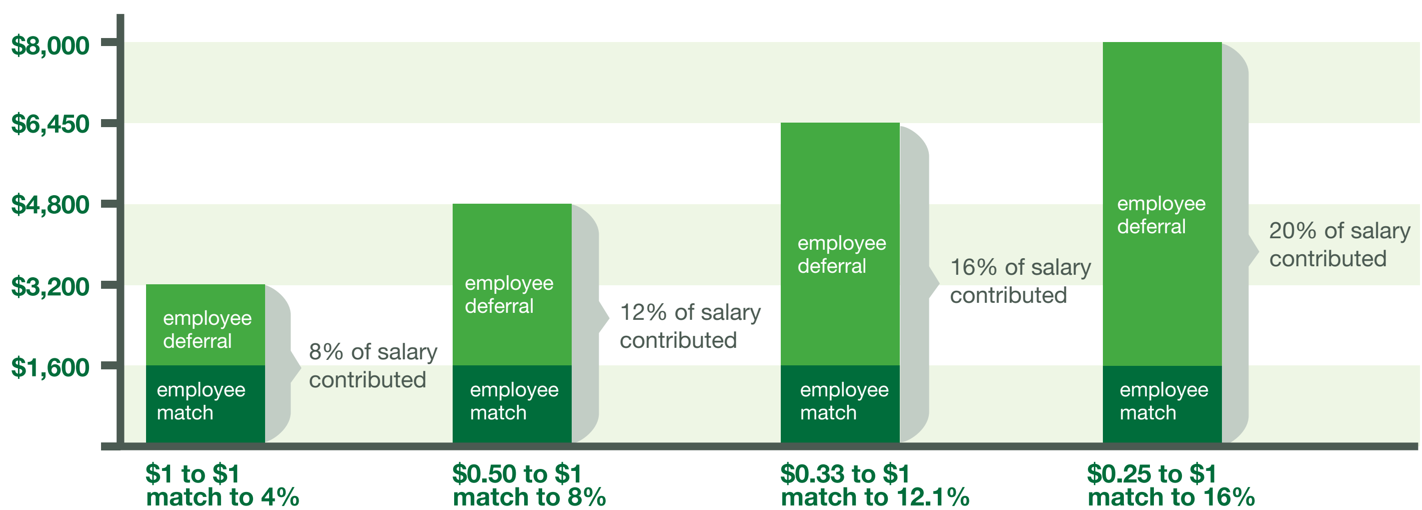
The amount and structure of a match is unique to each employer. Courageous plan design strives to leverage as large a contribution as the employer can bear in a way that encourages maximum deferrals from employees. Your plan advisor can help you put into place a creatively designed matching program that maximizes the incentive for your employees to contribute aggressively toward their retirement savings.

The Stretch Match

The most common matching formula is 50 cents on the dollar, up to 6 percent of pay. However, if an employer wants to incentivize workers to put in more than 6 percent, it could match 25 cents on the dollar up to 12 percent of pay, with no increase of its cost. Aptly called the "stretch match," this approach is designed to "stretch" the employer matching dollars while motivating employees to save at higher levels. The maximum financial commitment of the employer remains the same, but participants have to defer more of their own salary to obtain the maximum match.

All of the scenarios in the following example involve the employer ultimately contributing the same $1,600 matching contribution, but the combined amounts contributed to the employee's 401(k) account are drastically different.

Total Amount Contributed to the Employee 401(k) Account



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Tax Diversification: The Roth 401(k) Option

As important as it is for an employer to provide attractive and easy ways to build retirement savings, the goal of courageous plan design is to give employees the option to pay taxes on those savings now, later — or both. Offering a Roth 401(k) alongside a standard 401(k) provides all three options.

With a traditional 401(k), savings aren't taxed going into the account, but when they are withdrawn during retirement. A Roth 401(k) is the opposite. Savings are taxed going in, but not when taken out, and earnings on qualified distributions are tax-free. What's the best option? It depends on the individual, which is why it's important that employers provide a choice.

For employees who are almost certain they'll be in a higher tax bracket when they retire, such as those who have several years left in the workforce, the Roth 401(k) may work well. Although more would be taken out of an employee's paycheck now, higher taxes are avoided later. The Roth 401(k) may also be a draw for certain highly compensated employees who can't make Roth IRA contributions because of their income level.

For employees who guestimate that their tax rate will be lower during retirement than it is now, or don't have long until they stop working, the traditional 401(k) is likely the better option.

But the reality is that the majority of employees simply can't know if they'll be in a higher or lower tax bracket when they retire. Having a Roth 401(k) option allows them to pay taxes now or during retirement, effectively diversifying their tax strategy so that all their bases are covered. In addition, a new law permits an employee to transfer funds from a standard 401(k) to a Roth 401(k) within the employer's plan, if the employer's plan is amended to allow the rollover.

If an employer plans on introducing a Roth 401(k), they need to effectively communicate the option, especially to existing employees. Roth participation is more than twice as high among standard 401(k) participants who were hired after the Roth introduction than among 401(k) participants hired prior to its introduction, according to a 2013 National Bureau of Economic Research study.[22]

Savings Leaks Prevention

Regardless of whether savings are amassed in a standard 401(k) or a Roth 401(k), they need to stay there until retirement. Through courageous plan design, employers have the ability to plug savings leaks that can damage years of an employee's accumulation or potentially cost him or her thousands of dollars in the long term. Courageous plan design espouses the most beneficial plan design for participants, which means no plan loans or hardship withdrawals. No law requires them, and removing them reduces the list of potential mistakes an employee can make during retirement preparation.

Damage Difficult to Undo

A Fidelity Investments analysis of loan and hardship withdrawal trends among 20,600 retirement plans, representing 12.3 million participants, illustrates that the retirement piggy bank is being raided far too often and that the damage can be cumulative and difficult to undo.[23] The study found that 1 in 9 participants took a new loan of, on average, $9,000. And the more loans a participant takes, the more likely he or she will take a hardship withdrawal. In the 12-year period reviewed, of participants who took one loan, 6 percent went on to take a hardship withdrawal. Of participants who took seven loans, 25 percent went on to take a hardship withdrawal.

That's billions of dollars being diverted away from savings and put toward non-retirement needs — $70 billion annually, to be exact, according to a 2013 study of Federal Reserve and U.S. Census Bureau data.[24] Even if the money taken out gets put back in, there are still destructive downsides:

Missed earnings – Money that isn't being invested cannot grow. Consider a man who is 35 years old and borrows $10,000 from his 401(k), repaying it each month over a five-year period. If he assumes a 7 percent rate of return on his investments and is paying 3.5 percent interest on the loan, he'll be positioned to lose $5,436 in retirement savings by the time he retires at age 65 —*if* he repays the loan on time.

Serial borrowing – Fidelity's loans and hardship study found that once a worker dips into the plan, it's more likely he or she will come back for additional loans.[25] Fifty percent of borrowers took just one loan; the other 50 percent borrowed multiple times.

Reduced contributions – Not only do employees who borrow money potentially miss out on earnings, they often choose to reduce their contribution rate by two percentage points, on average, says the same Fidelity study.[26] The average deferral rate for participants who took loans was 6.5 percent. The average rate for participants who never took a loan was 8.5 percent. Just as damaging, it typically took two years after the loan was paid off for them to climb back up to their original deferral rate. In addition, employees are generally prohibited from making elective contributions to the plan for at least six months after receiving a hardship distribution.

Loan defaults – If an employee under the age of 59 ½ loses or leaves a job, an outstanding loan that's not repaid in full (typically within 30 to 60 days) often defaults. If a default does occur, the amount is considered a premature withdrawal, meaning it's subject to federal tax, state tax and a 10 percent penalty. Some plans are beginning to allow terminating employees to continue repaying outstanding loans through bank drafts. However, if an employee is between jobs and in a cash crunch, it can be extremely tempting to default on the payments, which could easily be a catastrophic blow to their ending retirement balance, so it is still advised not to allow employee loans from the employer plan.

Extra costs – Tax gets paid twice on loan interest because participants pay loans back with after-tax dollars. In addition, early hardship withdrawals typically come with a 10 percent penalty and are taxed as regular income. Unlike loans, withdrawals cannot be repaid; the savings are simply gone.

Limiting, if Not Eliminating, the Damage
Although it's clear that including loan provisions and hardship withdrawals can eviscerate the goal of a retirement plan, which is to be a savings mechanism for the future, staving them off can be a challenge. Some employers are afraid to remove flexibility from their participants' hands.

But if you aren't going to remove these options, you can still limit the damage they can do. For example, your plan design can limit the taking of loans to once a year. Or you can automatically reinstate an employee's contributions to the plan after the suspension for a hardship withdrawal is over. Your plan advisor can provide several options for consideration and work with you over time to communicate the benefits to participants and move you toward the end-goal of complete removal of loan and hardship withdrawal provisions.

Limiting Plan Investment Options

The courageous idea of limiting certain options in a 401(k) for the financial benefit of the participant goes beyond plan loans and hardship withdrawals; it also pertains to investment options. Over a decade of research, and a financial landscape permanently scarred by the collapse of companies such as Enron and Lehman Brothers, supports the courageous plan design recommendation of limited investment options that exclude company stock.

When Less Is More

In 2001, the director of a large mutual fund company read a new study that found supermarket shoppers were more likely to buy a jam if they had only six choices compared to 24. He wondered if the reason for steadily declining 401(k) participation rates among the 900,000 employees they covered could be related to the fact that the average number of funds in each plan was increasing.

After examining the investment records, lead researcher Sheena Iyengar, who has made a career out of studying how people perceive and respond to choice, did in fact determine that the gradual creep in number of options had a significant negative effect. Participation rates fell from a high of 75 percent for the smallest plans, which offered four funds, to 70 percent for plans that offered 12 or more. After the number of options exceeded 30, the participation rate continued to drop, until it hovered above 60 percent for plans with 59 funds, according to Iyengar's book *The Art of Choosing.* [27]

What's more, the employees who participated made less sound decisions when they had more choices. More than a decade of research later, the premise that choice overload can be extremely negative holds. A 2010 study led by Iyengar looked at over 500,000 employees in 638 institutions and found that with every additional 10 funds in a plan, equity fund allocation drops by 3.28 percent, and there's a 2.87 percent increase in the likelihood that participants will allocate nothing to the funds.[28]

With more investment options also comes the risk of more administrative and transactional expenses, which can translate into higher fees for the employees that can severely affect their final account balance. So although the problem is clear, a question remains: "What's the 'right' number of options?"

The minimum for most employers is three substantially different options, which puts them in compliance with the DOL's safe harbor guidelines. The maximum is still up for debate. A 2011 Transamerica Retirement study found that plans offering 10–14 funds have the highest participation rates, and participation rates decline as more are added.[29] Working with a knowledgeable plan advisor can help you decide what number of options will drive the most retirement success for your employees.

Taking Stock of Company Stock

As companies look for ways to cut back on investment options, the first one they should consider removing is company stock. Yes, it can offer some advantages, but practical factors as well as fiduciary ones outweigh them. On the practical side, employees' current livelihood is substantially, if not 100 percent, tied to the health of their employer. If a good portion of the employees' retirement is also based on company stock, not only is their current financial health tied to a single company, their future financial health is as well.

From a fiduciary standard, there's been an onslaught of legal cases being brought against fiduciaries alleging that it is imprudent to offer company stock as an investment option to participants. Although the vast number of these cases are found in favor of the fiduciary, they are a costly, time-intensive reminder that the sophistication level of plan participants, which is generally low, needs to be considered when selecting investment options.

The majority of participants don't know how to diversify from a single stock. And the more volatile of an investment option you offer them, the more dangerous it is in their hands, and the more fiduciary risk an employer incurs. Additionally, an employee may feel pressure to purchase company stock, imagined or implied, which is never acceptable.

The good news is that many companies already recognize the dangers of company stock in 401(k)s. The share of 401(k) accounts invested in company stock was steady at 8 percent in 2011, falling by more than half since 1999, according to EBRI.[30]

In addition, a 2012 survey of companies found that 94 percent provide matching contributions in cash versus company stock or cash and company stock. Just 3 percent of companies stated that they matched solely with company stock, down from 17 percent in 2003.[31] Clearly, if a company is reliant on its stock for making a match because they don't have the liquidity to do so in dollars, then it's going to be difficult to remove. The same 2012 study also reported that 93 percent of companies held less than 20 percent of total plan contributions in company stock, compared to 64 percent in 2002 — a positive step toward complete elimination.

The Business Benefits of Retirement Readiness

To fully embrace courageous plan design, it can help employers to understand why the seismic shift of responsibility that's in employees' best interests is in their own best interest as well. Building a retirement-ready employee base can result in a stronger, more successful business now and in the future.

The Benefits

Increase employee performance, attendance and productivity. Research shows that financial distress, including retirement unpreparedness, causes distractions that disrupt employee performance, attendance and overall productivity. For example, a 2012 study of employee benefits trends states that 22 percent of employees said they took unexpected time off work in the past 12 months to handle a financial issue and/or spent more time than they felt appropriate handling personal financial issues at work.[32] Preparing employees for retirement can help reduce the financial stress on employees, with lower absenteeism and presenteeism (attending work while sick) with higher productivity likely to follow.

The High Cost of Financial Stress

When employees work while sick because they perceive they cannot afford to stay home (presenteeism), companies lose big. Clearly, sick employees are likely to be less productive than their healthy colleagues.[33] Presenteeism and absenteeism associated with poor health cost the U.S. economy an astounding $227 billion per year. Driving the point home, a 2012 survey of almost 30,000 workers found that presenteeism accounted for 66 percent of lost time per week, and absenteeism accounted for the rest.[34] Putting into place a courageous 401(k) program that reduces the amount of financial stress an employee needs to manage can make a meaningful impact on a company's bottom line.

While a 401(k) is now a common benefit, a courageous 401(k) plan that clearly has employees' best interests in mind isn't.

Improve nondiscrimination test performance. Nondiscrimination rules are designed to prevent situations in which owners, managers and highly-compensated employees are able to save for retirement with the company plan while lower paid or rank-and-file employees are not. The rules require the administering of tests that compare plan participation and contributions of rank-and-file employees to owners/managers. Plans that have very low average deferral percentages for their rank-and-file employees are often forced to refund amounts owners/managers have contributed throughout the year and/or make special contributions on behalf of rank-and-file employees. But when a company implements automatic enrollment, it gets more participants, most of whom defer at whatever the default contribution percentage is. As a result, highly paid employees can save more, and the company can eliminate the need to return portions of the executives' contributions and/or provide non-highly paid employees special contributions.

Attract and retain top talent. Being able to offer potentially highly paid employees the ability to save well for retirement can set a company apart from its competition. Also, while a 401(k) is now a common benefit, a courageous 401(k) plan that clearly has employees' best interests in mind isn't.

Evolve your workforce. By preparing workers to retire on time, companies have the ability to make room for new workforce members with advanced skill sets and fresh ideas at potentially lower salaries.

Eliminate costs associated with "stuck" employees. Helping employees retire on time also reduces expenses associated with an aging population of employees who want to retire but can't afford to: lost productivity, increased health care costs, workers' compensation costs and more.

Improve company morale and loyalty. If employees see that their older counterparts can't retire, they may be compelled to seek employment elsewhere.

Managing Costs

Employers want to know if the benefits of courageous plan design outweigh the increased expense that can come with its implementation. It's a reasonable question with a reasonable answer: Pay now or pay big later. Organizations can suffer the cost of retirement unpreparedness at a later date — or invest in the future of the business and their employees today. And the costs may not be as high as one might initially expect.

From an administrative standpoint, the financial impact is often limited. Most companies have in place the technology needed to implement automatic features relatively seamlessly. However, if a company struggles with getting good employee data, it has a greater likelihood of errors that can result in the need to make potentially expensive non-elective contributions.

If cost is a concern, work with your plan advisor to make the most impactful changes possible.

Clearly there are monetary concerns to consider when a match is offered or increased, but, as noted above, innovative matching strategies can help keep the costs in line with a company's comfort level. In addition, the costs will likely be more modest than expected. One reason is that a large amount of employees who haven't yet enrolled and then are automatically enrolled have lower earnings.[35] Another is that the new enrollees are contributing at the initial automatic contribution level, as opposed to the highest level of the match, giving companies time to budget for future increases.[36]

Above all, it's important to remember that while courageous plan design in its entirety is the ideal, employers shouldn't take an "all or nothing" approach when cost is an issue. Work with your plan advisor to make the most impactful changes possible for your employees now and to plan ahead to make further improvements.

A Note on Communication

Ideally, employees making contributions to a 401(k) plan would be debt-free. Some financial experts recommend putting a temporary stop to investing in a 401(k), even if it has a match, if a person is working themselves out of debt. A comprehensive financial literacy program that teaches employees how to make informed decisions that help them achieve financial stability is a precursor to getting and keeping them enrolled in a plan.

In addition, ongoing education for plan participants is critical — especially if automatic features are being used. Although the features remove a significant amount of initial decision-making from employees, that doesn't mean they can simply go on autopilot. More than ever, companies need to educate in a way that makes enrollees aware of the consequences of their financial decisions. The strategies need to evolve away from a broad focus on process, such as plan mechanics, investment product selection and accumulation, to a more personalized focus on outcomes, including retirement outcomes, savings objectives and retirement income.[37]

In other words, companies need to clearly show an employee the future version of himself and provide ways to improve the picture. Yet data indicates more than two-thirds of plan sponsors utilizing automation still emphasize instructional topics instead of outcomes.[38] As you consider courageous plan design, you and your plan advisor can discuss communication strategies that will align with your new offerings.

Courageous 401(k) Plan Design

- Automatic enrollment of new and existing employees with a 6 percent – or higher – default contribution rate
- Automatic 2 percent escalation of the default contribution rate each year, with no cap
- An approved qualified default investment alternative
- A generous and creative matching program
- A Roth 401(k) option
- No plan loan or hardship withdrawal options
- Limited investment options
- Exclude company stock

Conclusion

Americans are ill-prepared for retirement, largely because they aren't contributing to their 401(k) plans at all or at high enough levels. They're battling inertia, unable to act even though they know they should. Courageous plan design is an aggressive solution that hands back much of the responsibility of retirement readiness to employers, empowering them to make decisions that are in their employees' best interests — and their own best interests as well.

At the end of the day, successful companies want to empower their employees to retire in a meaningful manner. The tenets of courageous plan design are a yardstick with which companies can evaluate what changes they need to make to achieve that goal.

Talk with an advisor experienced in 401(k) plan design about the innovative ways that you can implement courageous plan design while managing costs and balancing fiduciary requirements.

The future success of your employees — and your company — depends on it.

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