Resisting the Path of Least Resistance

Their own behavioral-finance issues can influence sponsors to forgo plan design changes.

BY JUDY WARD

nertia, excessive fear of negative results, prioritizing short-term needs — ahh, the challenges of dealing with plan sponsors on plan design improvements.

When advisors make the argument for implementing design best practices, the dynamics of behavioral finance apply not just to participants but to many plan sponsors in agreeing to make those design enhancements. “We only think about behavioral finance in terms of investors,” says Stephen Horan, a managing director at the CFA Institute. “But the principles are just general biases in all decision-making. The same behavioral factors influence 401(k) sponsors.”

Along with tangible concerns such as costs, the behavioral factors that lead participants astray also can impact sponsors’ willingness to change. “You always have a small segment of plan sponsors who like being ahead of the curve,” says advisor Jim O’Shaughnessy, a Northbrook, Illinois-based managing partner at Sheridan Road. “But with the retirement plan, a lot of companies take the approach of, ‘If it’s not broken, let’s not make any changes.’ The path of least resistance is to do nothing — which is exactly what we’re talking about with participants.”

Let’s hear from some industry experts about how behavioral finance comes into play and how advisors can help.

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Staying with the Pack

Many sponsors want to be in the pack, not in front of it. “A big part of that is the fiduciary concern,” says Bill Karsten, a Chicago-based senior consultant at advisor PlanPilot. “It’s that fear of making a bad decision that could have personal liability consequences for them.”

Some sponsors also have a philosophical issue with more-aggressive plan design, says Brady Dall, senior vice president at Sandy, Utah-based 401k Advisors Intermountain. They worry about taking on too much of a role of Big Brother, he says: “Their big concern is, ‘Why do we need to be their parents?’”

Enter the advisor, with an answer. “It is up to a proactive advisor to make them understand that employees need help,” Dall says. “If an advisor rolls over and plays dead, 90% of companies aren’t going to do anything. If a committee kiboshes it in one meeting, we always say, ‘We want to put it on the agenda for the next meeting.’”

O’Shaughnessy agrees. “A lot of times, it’s how I manage the situation, in not just taking the first ‘No,’” he says. “I may have to take two, three or five ‘No’s’ before they want to move forward.” During that time, he says, he and his Sheridan Road colleagues speak often to the sponsor about optimal plan design. “We’re talking about, ‘This is where we see the industry today, and here is where we see it going in one, three, five or 10 years,” he says. They talk about it both in terms of regulatory developments and emerging best practices.

Advisors can help by sharing with sponsors industry statistics and client case studies that illustrate the move toward enhanced plan design to improve participant outcomes, says Glenn Dial, head of retirement strategy at Allianz Global Investors in New York City. An advisor also can talk to a sponsor about the reality that if the sponsor does not pursue best-practice design features, that sponsor effectively makes the statement that those do not serve the best interests of that plan’s participants.

“If you look at the decision-making process — and this is a harder conversation to have — many plan sponsors do not realize that by not making a decision, they are making a decision,” Dial says. “There is no neutral position.”

Framing Decisions

The framework in which sponsors think about plan design changes plays a part in their decisions. “What is the goal of your plan? That is going to decide how you implement these things,” Dial says. “If your goal is to truly be a retirement plan, and for employees to end up replacing a certain percentage of their income, then document that.”

Encourage sponsors to think through their plan goals, and put them in writing. “We push for documented goals,” Dall says. “The goals used to be around having better metrics than the peer group. Now, we focus on one measurement: getting people ready to enjoy their vision of retirement.” Setting that singular goal makes subsequent conversations about plan design simpler, he says.

The intensified focus on fees and value received has helped spur more sponsors to willingly have this discussion, O’Shaughnessy says. “A lot of what we’re trying to put the focus on is: ‘What are the long-term objectives of the plan?’” he says. “That is difficult for them, because they’re being tasked in their day-to-day job to create short-term results, but we find that it’s critical.”

Sheridan Road has found it helpful to schedule a fifth meeting with sponsors each year that focuses more on planning, O’Shaughnessy says. At that meeting, the sponsor and advisor have a more focused, in-depth discussion on improving plan design. At regular quarterly meetings, he says, “In a lot of cases, those discussions are left toward the tail end of the normal review, and there is not enough time to have an adequate discussion.”

Feeling Inertia

Not only participants suffer from inertia: When it comes to strengthening auto-enrollment features, it often affects sponsors, too. “A lot of people don’t want to be on the leading edge,” Dial says. “They wait for others to do it.”

Many sponsors feel reluctant to boost auto features beyond the automatic enrollment safe-harbor provisions, despite the reality that they aren’t enough to lead to adequate retirement savings. “There’s this concern that they really want to stick to

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the guidelines," Karsten says. "They don't understand that these are the bare-minimum guidelines."

And many sponsors worry about employee reaction if they go beyond the safe-harbor minimums. "Without trying it, many folks just assume that it won't work," Dial says. "We've got the silent majority, and then we've got the 'squeaky wheels,'" who tend to make themselves more visible, so their opinions can get weighed more heavily. "Sometimes we let the fringes of the workplace dictate plan design," he says.

An advisor can explain to sponsors the compelling reason for moving forward. "It's up to the advisor not to be a pushover," Dall says. "We constantly reinforce to committees, this [plan design] is the single most powerful way that you can create better outcomes for your employees."

Troy Hammond, president and CEO of Santa Barbara, California-based advisor Pensionmark Retirement Group, also points to an advisor's critical role. "We can sit down with the plan sponsor and say, 'Look, here's the right thing to do, and you're almost there. If what you're really trying to accomplish is to create some financial security for employees at retirement, you have to be more aggressive,'" he says. "I would point the finger at advisors and say, advisors need to step up. They need to show the empirical data and encourage plan sponsors to make changes."

Pensionmark shares with sponsors data from its previous plan work that illustrates employee reaction to higher auto features. "Whether you auto-enroll people at 3% or 6%, guess what? The same amount of people stay in," Hammond says. "Whether you auto-increase people at 1% or 2% a year, guess what? The same number of people stay in."

Overweighting Backlash Fears

Despite success in automatically enrolling new hires, many sponsors still haven't done it for non-participating current employees. While budget issues play a role, focusing too much on potential negative participant reactions also explains part of it. Some HR staffers "are afraid that there will be backlash from the 'squeaky wheels,' and that is going to create more work and problems for them," Dial says. Facing a very heavy workload already, he says, "They say, 'I don't want to deal with it.'"

Pensionmark uses evidence from reenrollment done at other plan clients to ease sponsors' worries. "We can change sponsors' perception of, 'I don't want to take money out of peoples' paychecks,'" Hammond says. "It's this perception that needs to change. What employees are really thinking is, 'I want to be in the plan.' We have found that nine out of 10 [reenrolled] employees thank you. We really don't get blowback."

Employers may struggle with feelings that their lower-wage employees already live paycheck to paycheck and can't afford higher contributions, Karsten says. "When we see that is the main issue, we have to back up and deal with that issue," he says. That can mean bringing in a third-party organization to provide help and education to participants on budgeting and debt-counseling issues, so that they'll be better able to save for retirement. "You are not going to get participants to contribute 5% or 10% if they are struggling with debt and just scraping by," he says.

401k Advisors Intermountain has been experimenting recently with an interesting way to show reluctant sponsor clients the real-life consequences of not doing reenrollment: It runs a mini-simulation of how reenrollment would have affected the retirement savings of actual employees. "In a committee meeting, we identify three long-time, valued employees from the company's database. Then we show the committee the difference it would have made to these employees if they would have been automatically enrolled from the start," Dall says. "We say, 'Frank hasn't saved anything. We've failed him.' This is a good tactic, because it brings some emotion to the committee."

Prioritizing Short-term Needs

Lenient 401(k) loan features give some participants what they want in the short term at the expense of the retirement savings they need in the long term. "If I had my druthers, you could not borrow money from a 401(k)," Hammond says, adding that he has seen participant "loan-aholics" at some plans. Some sponsors agree with him in theory, but they also can remember stressed, cash-strapped employees coming into their office to take a loan. "There's an emotional component to it," he says. "When you have the emotional heartstring, it's a challenge to take that away."

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Advisors can help balance that by illustrating to sponsors the negative impact of their lenient loan provisions, Dall says. To do that, 401k Advisors Intermountain runs a plan-level analysis of what loans have cost participants in terms of lost investment

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returns, negative tax consequences, and the number of defaults.

Few employers will eliminate loans altogether. "For most of our clients, their approach is that the loan provision is important to give participants comfort that if they need access to the money, it is available," O'Shaughnessy says. "But a lot of clients are wiling to go down to allowing no more than one or two loans outstanding at a time. The issue is, what is in the best interests of participants? Do they want participants to have a ton of flexibility with loans?"

Some sponsors who don't want to limit the number of loans will agree to only allow participants to take money on loan from their own contribution, and not from the employer match, Dall says. "So these employers are saying, 'We are providing the match specifically for retirement, not just as a cash bonus,'" he says.

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OUTCOMES NOT YET ON EMPLOYERS' RADAR AS SUCCESS MEASURE

While behavioral finance clearly has had an impact on participant outcomes, outcomes don't seem to be very high on the priority list for plan sponsors.

Asked how they felt their organizations did on several key plan success measures, overall participation rate ranked highest, and was most commonly measured, according to an American Century survey of 310 plan sponsors. Participant outcomes, not so much.

Regarding overall participation rates as a measure, 83% of respondents formally measured overall participation rates. But only 28% of the plan sponsor respondents formally measure how ready employees are for retirement. Still, 5% feel they are doing an excellent job here, 17% a very good job, and 39% a good job. Just 7% say they are doing a poor job, but 10% admit they don't know.

Nor do plan sponsors appear to be concerned about their accountability for those participant outcomes. Asked about their level of concern that employees might sue if they don't achieve the results they feel they should, nearly two-thirds (63%) said they were "not concerned." Only 7% were "very concerned," and 27% were "somewhat concerned."

Among the other measures of plan success:

- 81% formally measured the percent of eligible employees taking full advantage of the match.
- 72% formally measure the general contribution rate.
- 68% track the participation rate of NHCEs.
- 61% monitor the percent of employees who contribute the maximum.

Ironically (in view of the success measures), when asked to rank the importance of several corporate goals when it comes to offering a retirement savings plan, "supporting employees' efforts to have a secure retirement" topped the list. That goal was cited as "extremely important" by 62% of respondents — outpacing the 54% who opted for the traditional "attracting and retaining workers."

Just 28% said that how ready employees are for retirement is extremely important (though another 47% said that factor was very important). The general contribution rate (24%) and percent of employees who contribute the maximum (17%) were also on the "extremely important" list.