ENHANCING PARTICIPATION

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Automatic Enrollment and Beyond

Times are changing! A few years ago, 401(k) plans were evaluated on their features...did the plan offer well-known mutual funds?...were the enrollment and education materials attractive?...was the website appealing and easy to navigate?

However, as more 401(k) participants approach retirement and as the 401(k) industry matures, the emphasis is changing from features to results. Or, more accurately, a successful 401(k) plan must have good features and must produce adequate and broad-based benefits.

That change was emphasized by a survey of large plans by Hewitt Associates.¹ According to that study, plan sponsors said that the best metric, or measurement, for the success of their 401(k) plans was the level of participation. The second choice was the adequacy of the benefits produced by the plans. Thus, approximately half of the employers considered those two measurements—participation and benefit adequacy—as the best ways for measuring whether their plans were working properly or not.

Of course, participation is not just a concern for large employers. That issue has also caught the attention of policymakers—the White House, Congress and the Department of Labor.
Consequently, Congress passed the Pension Protection Act of 2006, which included provisions about automatic enrollment, safe harbor automatic enrollment, and qualified default investment alternatives (or QDIAs) that were intended to increase participation and enhance diversification in 401(k) plans. In considering that legislation, Congress was encouraged by reports that automatic enrollment often resulted in participation rates of 90% or higher. \(^2\)

As a result, automatic enrollment is now a favored form of designing and operating 401(k) plans...because it supports the policy that more Americans should be saving for retirement.

However, automatic enrollment is not the only way to increase participation. Broadly stated, there are three ways to increase participation...the first is through plan design, the second is through educational services and the third is through specially designed participation programs. Modifying any or all of these can make an impact if the plan sponsor makes changes based on the needs of their actual plan—not just because a method is popular.

**Plan Design**

In my experience, the design features most commonly used to increase participation are early entry dates, matching contributions and participant loans. The use of those features for this purpose is based on the belief that a properly designed plan can increase the levels of participation.

For entry dates, the common view is that, the earlier the entry date, the greater the level of participation. In other words, if participants can enter plans immediately upon hire, or shortly thereafter, a larger number of employees will participate. Conversely, though, the longer the participants have to wait before they can get into the plan, the lower the initial levels of participation. This view is consistent with the practice of employers using shorter and shorter waiting periods for 401(k) plans. \(^3\)

Higher matching contributions are believed to increase participation because of the “free money.” For example, if an employer has a $.50 match on the first 3% of pay that is deferred, employees immediately "earn" a 50% "gain" on their investment. Obviously, any economically motivated employee would want to take advantage of that. As a result, plan sponsors should design their 401(k) plans to have an appealing matching contribution and should actively communicate the value of the match to the participants.

Finally, participant loans are considered to be important for designing an attractive 401(k) plan and for encouraging participation. The thinking is that, if employees know that they can get their money back if needed (through borrowing it), they will feel more comfortable deferring into the plan. Of course, the downside to loans is that participants are losing time invested on the assets borrowed, and may have less saved at retirement.

While it is not entirely clear that, for a given employer, any of these features will make a difference, it is widely believed that, on average, they will marginally improve participation levels. Changes like these may be worth discussing with your financial advisor or plan provider, even if for no other reason than to discover the ways in which other plans are experiencing increased participation.

**Educational Services**

Most plans offer financial education, investment education, and enrollment meetings with the belief that they will increase participation. Based on my own experience and conversations with others in the industry, I believe that printed materials are only marginally effective; however, face-to-face meetings can be very effective. I have heard that well-run enrollment meetings can increase participation by 10% to 20%, and I have heard of financial advisors who, through one-on-one meetings, have increased participation dramatically—
up into the 90% range. Some advantages of these face-to-face meetings may be that participants feel freer to ask questions and can more easily gain the specific information they personally need to be comfortable with their financial planning decisions. For others, the benefit of a face-to-face meeting may just be the motivation to participate or to participate at a higher level that other communication methods just can’t deliver.

Participation Programs
While automatic enrollment is, on average, the most successful of the participation programs, some employers may be reluctant to use automatic enrollment because they feel like they are taking money out of their employees’ paychecks, because of concerns about increased cost or complexity, because of fear of fiduciary liability, or for other reasons. In those cases, there are two other techniques that can be used by plan sponsors to increase participation. The first is “mandatory” elections and the second is “easy” enrollment. By mandatory elections, I am referring to a process where each employee must turn in an election form—even if the election is that the employee does not want to participate in the plan. Under this scenario, all the eligible employees are told that they must turn in a form and, if they do not, they will be specifically requested to do so. Some plan sponsors have told me that this process can increase participation by 5% to 15%. That suggests that a number of eligible employees do not participate because they don’t know what to do. However, if they are required to make a decision, some will decide to be in the plan. In other words, it takes the “fence sitters” off the fence.

By easy enrollment, I am referring to a process where, after the initial enrollment, eligible employees who did not turn in a form are provided with an easy process for participating in the plan. For example, the plan sponsor might give each unenrolled employee an addressed, stamped postcard that, if signed and returned by the employee, will place the employee in the plan with, for example, a 3% deferral rate and in the age-appropriate target date fund. There are a variety of ways of designing that process, but the key considerations are that: (i) it requires nothing more than the employee’s signature on the form; and (ii) it requires the least possible effort to return the signed form (for example, an addressed and stamped postcard or envelope). Based on conversations with employers who have used this approach, it can increase participation by 10% to 20%.

Conclusion
Plan sponsors are beginning to focus on the results their 401(k) plans are producing. Ultimately, successful results will be measured by whether the plans provide adequate benefits for participants. However, for now, the key metric is participation. For plan sponsors who are focusing on these new definitions of success in their 401(k) plan, it will pay to be aware of all of the possible steps that can be taken to increase the levels of participation.

2 Also see the Preamble to the 404(c)(5) regulation.
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