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Saving While There's Time

With personal nest eggs and other retirement coffers dwindling while costs increase, employers need to light matches under 401(k)-wary workers before it's too late.

BY SUSAN GUREVITZ

When it comes to 401(k)s, employees don't seem to want to make many decisions, including whether to enroll or raise their contributions. Baby boomers have been some of the worst offenders, yet can least afford to ignore their retirement plans. In fact, a recent study by Guardian Life Insurance Co. found that, while 80 percent of boomers are concerned about having enough income during retirement, exactly half say they aren't sure how much money they will need.

As pundit and economist Ben Stein points out in an article entitled, Baby boomers warned to start now to avoid poverty in old age, published in conjunction with National Retirement Planning Week last fall, "... to be retired and in your 70s and not know how you are going to pay your bills ... it's a grotesque nightmare."

Stein goes on to paint a picture of a woman in her mid-50s who's living on an annual salary of $150,000, wants to retire at 65 and maintain her living standard and, accounting for inflation and current interest rates, will probably need about $4.6 million in the bank. Pretty scary numbers for the roughly 77 million baby boomers who may or may not be saving in a 401(k)–or anywhere else, for that matter. According to Fidelity Investment's 2003 Building Futures report on participant demographics and behavior, which covers 8.2 million participants, the percentage of employees in the 40-to-49 age group participating from 2001 to 2003 only rose to 31.7 percent from 31.4 percent. The employees ages 50 to 59 scored a bit better, with participation moving to 22.9 percent from 21.7 percent. Consider also the national savings rates reported by the Employee Benefit Research Institute–50 percent of all workers and 34 percent of workers ages 55 and older say their total savings, excluding the value of their homes, are less than $50,000.

Clearly, employers have to pay close attention. As a society, we've traditionally relied upon the so-called "three-legged stool"–Social Security, employer-provided retirement plans and personal savings. These days, with a shaky Social Security system on the horizon, "employers are concerned that the burden of retirement will fall more to them, perhaps through greatly increased Social Security taxes or more limited Social Security benefits," says Kal Muchnick, vice president and director of defined contribution services at The Savitz Organization in Philadelphia, a group of employee benefit consultants and actuaries. No company wants to be left holding the retirement bag, so to ensure American workers can safely retire when they want to or should, it behooves employers to provide more benefits now–to, in effect, stabilize the three-legged stool.

Rusty Field, vice president of financial education and planning services at American Express Retirement

Services, discusses this potential shift in responsibility in the 2004 Guide to Workplace Financial Education and Advice, noting the ... "added benefit burden for employees may mean postponement of retirement." No one wants older workers staying on because they can't afford to retire. Field says in the guide, "Companies' bottom lines are likely to be affected by the retention of older, more expensive employees." That's why it makes sense to encourage this large wave of pre-retirees to save as much as they can now so they can retire. It's worth mentioning, too, that older workers reluctant to retire can prevent companies from bringing in the much-needed innovations and energies of younger workers.

So what's a human resource executive to do? The trick, of course, is to get employees to sign up for 401(k)s in the first place, but encouraging enrollment isn't always easy. Some of the traditional methods may not be an HR professional's best bet anymore. For one, it can be pretty intimidating that first day of work or during an enrollment meeting to be handed a 2-inch-thick packet of retirement-benefit materials with directions to "sign up for your 401(k) now."

"Traditionally we've assumed [employees] don't want to enroll if we don't hear back from [them]," says Michael Weddell, retirement consultant with Watson Wyatt Worldwide in New York. "There's no urgency. The employee can just take the packet home and file it away."

By the same token, if the employee doesn't respond, then the assumption has been that he or she doesn't want to sign up, increase a contribution or change what might be a very conservative investment choice.

"Why should the default choice be the worse choice?" says Weddell. In general, participation rates for all age brackets have been far from spectacular. According to Lori Lucas, director of participant research at Hewitt Associates' Chicago office, only 45 percent of people in their 20s participate in retirement programs–it seems so far away–while 71 percent of people in their 40s and 72 percent of people in their 50s contribute to 401(k) accounts. Plan changes, such as the availability of immediate enrollment, have been boosting those figures, but sometimes, employees need a different kind of nudge.

Auto Pilot Programs

Companies of varying sizes have been rolling out automatic enrollment programs since the mid-1990s, when 401(k) consulting gurus began to determine that the best way to motivate employees to make decisions was to capitalize on their tendencies to make no decisions at all. In other words, you can take advantage of two major psychological inclinations–inertia and procrastination.

"If we don't hear from [employees], we'll assume [they] don't mind being enrolled at whatever default level we pick," says Weddell. Anywhere from 10 percent to 20 percent of all companies now offer auto-enrollment programs. More specifically, according to a survey conducted by the Profit Sharing/401(k) Council of America, 8.4 percent of companies of all sizes offered auto-enrollment programs in 2003, while 24.2 percent of companies with more than 5,000 employees offered such programs, also referred to as autopilot plans. Thus far, they're more prevalent with larger companies, and growing.

Autopilot plans kick in during open enrollment periods or when an employee is hired. According to an early three-month study in 2001 with 15 clients by the Vanguard Center for Retirement Research in Malvern, Pa., participation rates rose to 84 percent from 75 percent for plans automatically enrolling newly eligible employees. For the plans that enrolled all employees, the rise in participation rates was most impressive, jumping to 90 percent from 73 percent.

Once an employee is enrolled in the plan, he or she has a full legal right to withdraw, but not many do because that requires making another decision and taking an action. "Once in, they tend to stay in. Inertia works for you," says Martha Terry, retirement consultant with Towers Perrin's office in Boston.

Automatic voluntary savings features are the latest tools for 401(k) savers to help them put away double-digit deferrals. Known as "save your raise" programs, they work something like one of those music or book clubs in which clients get free or discounted books today and promise to buy more within a year. With "save your raise," workers make commitments today for a future action to take place at a certain time. With a 401(k), the employee might commit to have 3 percent deferred from his or her paycheck today, but sign up to have some percentage of a raise–say 1 percent–added to his or her deferral each subsequent year. So, the following year, that deferral would be 4 percent; the year after that, 5 percent, and so on. Eventually, an organization's employees might be having 10 percent to 12 percent deferred–a healthy contribution, and painless. The idea is they won't miss the money while they're building up their savings. "The easier you make it for people, the better off you're going to be," says Lucas of Hewitt Associates.

So far, Vanguard's one-year-old program, known as "One Step Save," has been offered to 400,000 people at 200 companies, and 5 percent, or 20,000 employees, have signed up to save their raises. "As word gets out, the 5 percent is trending upward," says Stephen Utkus, principal of the Vanguard Center for Retirement Research. "You're using default rules to shape employee behavior," says Weddell of Watson Wyatt. "You present it as, 'This is the normal way to do it; if we don't hear from you, this will happen,' " he says. Otherwise, people tend to ignore their contribution levels, and frequently won't raise them unless they happen automatically.

'Set It and Forget It'

It naturally follows, then, that the next wave of automated retirement plans combines auto enrollment and auto contribution increases, plus an automatic asset allocation. Fidelity's Freedom Funds, originally introduced in 1996, now come with automatic features and are available through more than 70 percent of the company's sponsor plans. The funds stress Fidelity's "set it and forget it" feature.

"There's an auto feature for every major aspect of 401(k) involvement–participation, annual increases and asset allocation," says Steve Deschenes, executive vice president of Fidelity's Institutional Retirement Services Co., based in Boston. That last piece allows participants to sign up for what's known as life-cycle funds, which are automatically rebalanced on a regular basis to fit predetermined retirement dates; invested funds get more conservative as investors age. "You need a suite of programs to reach all employees to meet the needs of each group of people effectively," says Deschenes.

Vanguard offers a similar program, dubbed "OneStep," not to be confused with "One Step Save," which is only for saving future raises. OneStep incorporates auto enrollment and auto contribution increases, and adds an automatic asset allocation element as well.

Falling under the domain of behavioral finance, it was only a matter of time before psychological factors would dictate the rules for developing innovative approaches to encourage baby boomers, as well as workers of other ages, to save enough to fund their retirement nest eggs.

Clearly, holding enrollment meetings–even with enticements such as food or giveaways–no longer attracts enough attention. At least one company tried offering its employees scratch-off lottery tickets as an inducement to attend an enrollment meeting, and many showed up. When no one struck it rich and the benefit counselors pointed out that it makes more sense to enroll in a retirement program than depend on a lottery win, participation rates did go up. But that kind of gimmick won't work at every company.

"You get to a point when you realize that employee meetings [with gimmicks] don't work because they don't have the follow-through," says Daniel Carroll Madden, vice president of global pensions with Illinois Tool Works in Glenview, Ill.

Sometimes, employees just need to be educated about basic financial planning before they can even think about signing up for 401(k) programs. "We had been trying to boost our participation rate, which was 55 percent, and we offer a 50 percent match for the first 4 percent, so why did we just have a 55 percent participation rate?" says Brooke Vanderver, director of benefits and HRIS at Children's Health System in Birmingham, Ala. "We realized it was more basic than that."

Through one-on-one discussions at enrollment meetings, she discovered many employees just needed to learn how to budget for a 401(k) contribution. Through an educational program offered by Financial Finesse of Manhattan Beach, Calif., begun almost a year ago, employees were able to call a certified financial planner with questions, helping to prepare them for 401(k) participation. As of mid-December, Children's Health System's 401(k) participation rate jumped to a much healthier 72 percent. And Vanderver expects that to go even higher, now that the hospital system has introduced automatic enrollment as of Jan. 1, 2005. "We distributed blank 401(k) statements to those who were eligible but not participating, and that really drove the point home," she says.

Critical Motivators

Indeed, driving the point home with baby boomers is becoming ever more crucial. Many studies today show that most have either underfunded retirement accounts or don't know how much they'll need for retirement. Other studies have shown that participation rates have been growing very little or even leveling off, a reminder that 401(k) plans haven't been around all that long. In addition, the downturn in the market over the past few years has only complicated matters, reducing balances in most everyone's 401(k) account. In many cases, those balances still haven't built back up.

According to research cited in a recent Wall Street Journal special report on retirement, entitled "The Great American Retirement Quiz," based upon a broad range of sources, individuals in the prime boomer age–50 to 59–had only an average of $88,000 saved in their 401(k)s in 2002, down 15 percent from the 1999 average.

Experts suggest that, if boomers haven't begun to save already, just the thought of starting any kind of a savings program is seen as overwhelming, despite the fact that they're typically at the higher end of their earnings cycle and can, therefore, afford to save.

Nevertheless, in too many cases, they don't. American Express Retirement Services research shows 44 percent of employees age 55 and older have less than $100,000 in their retirement plans, and 48 percent age 45 to 54 have less than $100,000 saved in their retirement plans, according to Field. Those are not terribly encouraging statistics, especially if the boomers are adhering to the retirement industry's rule of thumb that they need to replace 80 percent of their income for retirement. However, that figure was calculated in 1988 by Aon Consulting with Georgia State University and comfortable lifestyle expectations have changed a lot since then. Recently, some have suggested that figure might be rising closer to 100 percent, or even higher. "After all, we really don't know what a 25-year-old is going to need when he retires," says David Wray, president of The Profit Sharing/401(k) Council of America in Chicago.

While automatic programs are the newest mechanisms designed to motivate employee enrollment and raise deferrals in their 401(k) plans, these options could require hefty technological investments by employers, so some HR executives are sticking with more conservative–albeit sometimes drastic–routes, such as offering vastly improved retirement plans.

For instance, with his participation rates languishing in the 70-percent-to-75-percent range in 1999, David Lacey, vice president of human resources at Technitrol of Trevose, Pa., a maker of electronic components and assemblies, decided to overhaul his entire 401(k) plan. As he recalls, he felt he had to do something, plus he wanted to add appealing features to attract and keep employees.

"We had to make it attractive from day one, and sell the plan features," says Lacey. "Too often, human resource people operate from an 'I'll make you feel guilty' standpoint instead of selling the plan features. They take it for granted and it becomes an 'ought,' such as, 'You ought to participate because the company is offering it.' You need to have a compelling proposition to put in front of the employees," he says.

Technitrol's new plan raises the company match to a dollar-for-dollar, up to the first 4 percent, from a 50-cent match, and permits new employees to participate immediately with no waiting period (there used to be a one year waiting period). In addition, new enrollees are vested immediately on the company's share as well as their own share. As a result of the changes, says Lacey, "our participation rate is well over 90 percent now."

Another motivator for baby boomers to contribute to their 401(k)s? The common knowledge that Social Security only goes so far. "When they get that Social Security Notice of Benefits in the mail," says Amy Heiserman, senior communication consultant with Mercer's Denver office, "that tells them, 'I guess I'd better save more on my own.' "