THE REAL MEASURE OF 401(k) PLAN SUCCESS

BY DR. GREGORY KASTEN

The Real Measure of 401(k) Plan Success

Today the 401(k) plan is more than an investment program, it is a retirement plan. How successful is your company's 401(k) retirement plan? Do you know?

In recent years, plan sponsors have been encouraged to measure their plan by tracking participation and deferral rates, monitoring investment performance, and benchmarking fees all of which are important, but none of which independently provide a complete guide as to whether or not participants are succeeding. Success is an employee being able to replace their paycheck when they retire.

The industry further confuses the issue by marketing plan health assessments and promoting 'retirement readiness' but few are able to quantify whether participants will actually be 'ready' at retirement.

Why Measure?

Like most plan sponsors, you probably consider the money spent offering and administering your retirement plan as an investment. It stands to reason that you and your plan advisor would want to know you're getting a good return on that investment in terms of helping employees achieve a comfortable retirement and auxiliary benefits to your company.

For example, if employees are satisfied with their retirement plan, they are more likely to keep working for the employer sponsoring the plan. Thus, having a "successful" retirement plan can lower employee turnover and save you the costs of recruiting and training qualified workers.

As we move into the future, how successful—or unsuccessful—a retirement plan is in delivering retirement security may become a factor in determining whether or not a plan sponsor and other plan fiduciaries are meeting their fiduciary responsibilities. Having a plan that doesn't measure up to changing industry standards could leave the fiduciaries open to potential litigation.

Common Benchmarks Used Today Miss The Point

Currently, the most popular benchmark is the plan's participation rate. A PLANSPONSOR DC survey found that 65% of plan sponsors that measure plan success look at the percentage of eligible employees who participate in the plan. Plan deferrals are another metric used. A quarter of the plan sponsors surveyed measure overall deferral rates and 19% look at the participants who defer at least the percentage of pay that will capture the full employer matching contribution.

Investment performance is often used as a benchmark for plan success. A common measure is to track the percentage of participants who are invested in at least three different asset classes or an asset allocation fund, such as a lifestyle or target-date fund. The goal is to determine how well diversified participants' plan investments as a whole are. In addition, advisors often cite overall plan investment performance net of plan fees as a success indicator.

These are factors, but not a true benchmark of retirement success.

Measuring Success

A retirement plan isn't just an investment plan. It's a vehicle to help employees be able to replace their paychecks when they stop working. And, while the other frequently used measurements provide some indication of how various aspects of the plan may be working, they don't measure what sponsors, advisors, and participants, alike, need to know. Will the plan successfully provide each participant with an adequate benefit at retirement?

To answer that question, work with your advisor to measure participant outcomes. How many of your participants will be ready at retirement? Current industry statistics show that only about 25% of participants are on target to having sufficient retirement income to last their lifetimes.

Improving Outcomes

Unfortunately education alone isn't enough to overcome the disinterest and inertia of many plan participants.

In fact, a joint university study on financial literacy, financial education, and downstream financial behaviors concluded that financial education has little impact on changing people's financial behavior. A national survey of retirement planning views reported that 56% of plan participants aren't aware of or don't review plan-related educational materials.

While educational materials may get participants thinking about retirement, you cannot depend on them to motivate participants to calculate their retirement income needs, contribute the necessary amount, invest their savings appropriately, and make necessary adjustments over time. Education works when advisors are in a position to deliver the answer rather than trying to teach participants how to do everything themselves. But first, you need the answer. And the answer must be easy.

Plan design can help. As many advisors already know implementing automatic enrollment, automatic deferral increases and automatic portfolio rebalancing can help direct participants toward better retirement outcomes. However, many participants need more —they need a goal and a personalized plan that is managed for them, keeping them on track to achieve retirement success. All they have to do to achieve that success is not opt out.

The Answer: A Holistic Approach

Improving plan outcomes requires a holistic approach, one that combines intelligent defaults—automatic enrollment, automatic deferral escalation, and rebalancing—with an actuarial solution tailored to each participant and ongoing personalized attention by an advisor. Case studies have shown that such a program can boost participant success from 25% to over 70% — at a cost competitive to, and typically less than, other managed account offerings. Employee acceptance is very high, often running 80% to 90% of the eligible workforce.

The solution should be developed from within the plan by the plan's named fiduciary, often the plan sponsor and/or administrator or a discretionary trustee, such as Unified Trust. A named fiduciary has the ultimate authority to control and manage the operation and administration of the plan. Most retirement plan service providers cannot furnish this kind of comprehensive program because, unlike a discretionary trustee, they do not exercise the discretionary authority over the plan and plan assets required for it to be successful. While the solution is managed by the plan's named fiduciary, the advisor plays a critical role in delivering the answer (retirement success) to participants.

Time for a New Conversation

Given the statistics on how few people are on track to be financially ready for retirement, the time has come to change the plan-success conversation and benchmark metrics that are actually going to have an impact on your participant's ability to retire.

How successful is your company's 401(k) plan?

It's time to find out. Ask your service provider to benchmark the success of your plan, not plan health, not participation rates, not fees, but rather how many participants are on track to replace at least 70% of their pre-retirement income. If you need assistance, we would be happy to run a complimentary plan success report on your behalf. Once you are able to quantify the success of your plan, you will be able to make a measurable difference in the lives of your participants.

About the Author

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