"Can Simple Informational Nudges Increase Employee Participation in a 401(k) Plan?"

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Synopsis by Parker Conway

Rapid societal changes and uncertainty in traditional federal retirement policies, leave many wondering if the average American will retire with financial security.[1] Although most acknowledge the importance of saving for retirement, employers still find workers do not always enroll in the savings plans offered to them. The Economic Policy Institute (EPI) reported in a 2013 study that almost half of American families have absolutely no retirement savings. The same report broke down retirement savings by age and found the median retirement account for families' ages 32-37 was $480.[2]

An employer-sponsored 401(k) plan offers employees a savings outlet, and may include an employer match, and other benefits such as investment growth prospects and tax advantages. Despite the benefits of a 401(k) plan, the choice to participate in a 401(k) is dependent on many factors including an employee's income and consumption preferences. Moreover, an employee might decline participation due to lack of information or insufficient understanding of a retirement plan and its benefits. Another reason might be that an employee has near-term financial obligations, such as repaying debt or saving for other priorities, which inhibit his/her ability to participate. Additionally, an employee might already have sufficient assets for retirement and therefore choose not to participate in a 401(k).[3]

If an employee has other financial obligations or already has sufficient assets for retirement, increasing participation in a 401(k) plan might be difficult. However, if the choice to forego participation comes from a lack of knowledge, could information help increase participation? Research from the late 1990's and early 2000's debates the impact of education on retirement savings programs.[4] To further investigate nonparticipation in employer sponsored 401(k) plans, Robert L. Clark, Jennifer A. Maki, and Melinda Sandler Morrill (CMM) conducted a field experiment to assess the influence of education as a decision factor in making the participation decision.

Preliminary Surveys

CMM partnered with a large financial institution (LFI) to conduct their study.[5] Before the experiment, CMM conducted a survey among newly hired LFI employees to better

[1] Joo and Grable, p. 37.

[2] Elkins, 2016.

[3] Clark, Maki and Morrill, p. 679-680.

[4] Joo and Grable, p. 48.

[5] The LFI used for the study is one of the top 10 financial service corporations in the country. LFI is a publically traded company with over 30,000 active employees in 13 states. LFI requires each employee to participate in an orientation that includes information about investing in the company's 401(k) plan. Employees are educated on the benefits of retirement savings and specifically on LFI's 401(k) plan. LFI allows employees to begin

understand the motivations underlying the participation decision in LFI's 401(k) plan. First, CMM wanted to better understand employee reactions and feelings towards the information received on the 401(k) plans offered. Second, CMM identified the most common financial limitations reported by newly hired employees that declined participation. Finally, they established whether financial literacy affects the employee's decision whether to participate in a plan. CMM used surveys to obtain their results.

To explore employee attitudes towards the information received about the 401(k) plan, the authors distributed a survey to all newly hired LFI employees. The survey results indicated that across all age groups, the majority of employees felt that the information they received during orientation regarding their options was very comprehensive. However, older workers (ages 45+) were twice as likely as those in the younger workers (18-44) age group to not have read the information at all. Moreover, about one half of all workers admit that the information received was not a determinant in their choice of whether or not to participate. Finally, younger workers were significantly more reliant on influences such as family and friends, when making their decision.

The survey was also designed to identify financial constraints that affected participation, Parallel questions were used for participants and nonparticipants of LFI's 401(k) plan to differentiate between limited and non-participation. The key factor in the decision of whether to participate was employer match. Among workers that were not currently contributing, 50% report that they plan on starting once eligible for employer matching. Following employer match, the next most reported constraint was "my salary covers my monthly living expenses with no extra room for retirement savings."[6] This reason was especially common among the younger workers who are also more likely to have student debt or is saving for a large purchase. On the other hand, older workers are more likely to take social security and other savings plans into account.

Finally, a separate survey was created and distributed to again to newly hired LFI employees to measure the importance of financial literacy in deciding whether to participate. The survey consisted of five questions to measure the employee's general financial literacy and understanding of the benefits of a 401(k).[7] The results indicate that the tax advantages of a 401(k) plan are not well understood by any group of employees. However, it was also observed that older workers have greater knowledge scores and higher rates of participation.

Field Study

From the survey results CMM deduced that knowledge distributed that informs and encourages employee participation could be effective. They conducted a field experiment to test the effectiveness of a low-cost intervention on increasing the rate of participants. CMM hypothesized that if financial literacy is the decision factor in 401(k) non-participation, then an informational "nudge" could be associated with increased participation rates.[8]

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contributing to the 401(k) on the first of the month after hiring date. All employees are allowed to contribute up to 50% of his/her total pay. Additionally, employees over the age of 21 that have completed a minimum of 1,000 hours of service in their first year are eligible for 100% employer match on employee's first 6% of contributions (Clark, Maki and Morrill, p. 682-683).

[6] Clark, Maki and Morrill, p. 688.

[7] The five questions include one question on each of the following topics: interest rates, inflation, investment, 401(k) tax advantage, and 401(k) employer match (Clark, Maki and Morrill, p. 690).

[8] Clark, Maki and Morrill, p. 690.

A flyer that highlighted the long-term benefits of investing in a 401(k) was designed and distributed to the treatment group of randomly selected LFI's new hires that were nonparticipants in the 401(k) plan. The informational flyer consisted of the same information that employees receive during orientation. The control group, made up of randomly selected nonparticipating new hires not given the flyer, was used as a benchmark to compare the changes in participation rates of the treatment group.

The authors reevaluated the participation statistics two months after distribution to give recipients time to enroll. They found that younger workers were 4.5% more likely to enroll in 401(k) when they received additional information. However, older workers that received the same flyer were 4.4% less likely to enroll in 401(k) plan compared to the control group.[9]

Key Findings

Although there are many reasons that an employee might choose not to participate in a company sponsored 401(k) plan, the survey was able to isolate the most important factors. The results indicated that employer match is a key factor for participation. Additionally, having funds money available that is not tied to other financial obligations (i.e. student loans, mortgage, etc.) is another key determinant in the participation decision. Most notably, for employers hoping to increase participation, the study finds that lack of financial education also plays a role in an employee's decision.

The results of the field study reveal that the effects of an educational initiative differed by employee characteristics. Most notably, the age of the worker impacts the effectiveness of the flyer; younger workers were more likely to enroll with the nudge whereas older workers are less likely to enroll with the same nudge. Additionally, the positive effect of the intervention with younger workers is concentrated among men, revealing that gender might also influence effectiveness. Finally, those most recently hired are more responsive to the intervention.[10] Due to the relationship between specific characteristics and effectiveness, tailoring informational materials to specific groups could be beneficial to increasing participation in a 401(k) plan.

Discussion

An important implication of the field experiment is the impact of the flyer itself. CMM attribute to the flyer the reason for differences in participation rates among the control and treatment groups. However, there is no indication as to whether the flyers were read by the treatment group, and therefore no indication that the flyer was the reason for increased participation.

A caveat surrounding this work is the timing of the study. The data that the authors used to analyze new hires ranges from 2008 until 2011, amidst a global economic crisis. A lack of confidence in investing was not uncommon after bond funds dropped 8% while well-managed portfolios fell 38% on average in 2008.[11] Even if an employee did not have capital invested, economic uncertainty alone could have influenced employee decisions on whether to allocate money towards retirement. The effects of the recession continued beyond 2008 and 401(k) accounts saw more borrowing and early withdrawals. In 2010, the percentage of people borrowing from their 401(k) plan increased to 16% from 13% in 2007. However, the average

[9] Clark, Maki and Morrill, p. 691-693.
[10] Clark, Maki and Morrill, p. 695-696.
[11] Brandon and Marquardt, 2009.

balance of a loan more than doubled over this same period of time.[12] Since it is nearly impossible to control for the nuanced impacts of the economic crisis of 2008 for each employee, additional research from a more stable economic time period might be beneficial.

[12] Brandon, 2012.

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