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"Successful Retirement Plan Communications for Various Population Segments"

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Members of the committee, it is a pleasure to meet with you here today. My name is Brigitte Madrian. I am the Aetna Professor of Public Policy and Corporate Management at the Harvard University John F. Kennedy School of Government and a Research Associate at the National Bureau of Economic Research. The views that I present here today are my own, and should not be attributed to Harvard University, the National Bureau of Economic Research, or any of my research collaborators.

For the past 15 years, my academic research has used the tools of behavioral economics to understand how individuals make savings and investment choices and how institutions and public policy can help improve retirement saving outcomes. The most widely cited findings from this research agenda document the impact of automatic enrollment in employer sponsored savings plans on 401(k) participation rates, savings rates, and asset allocation. This research has been influential in motivating the inclusion of provisions that encourage employer adoption of automatic enrollment in the Pension Protection Act of 2006. New Zealand and the U.K. have also enacted pension reforms that incorporate automatic enrollment in response to this research.

I would like to begin today by briefly summarizing what we have learned from behavioral economics about retirement savings outcomes:

- What seem like small barriers can in fact be substantial impediments when it comes to behavior change in any domain, including savings
- Most people want to save for retirement and not participating in a savings plan is often more indicative of a barrier to action than a lack of desire, or even an inability, to save
- Because they lack financial expertise, many individuals are overwhelmed by decisions about how much to save or how to invest for retirement—this limited financial literacy is an important barrier to taking action
- Individuals are not particularly adept at integrating across different components of the household balance sheet—they make decisions in one financial domain without fully taking account other financial domains
- Plan design features such as automatic enrollment have been much more successful in changing savings outcomes than providing financial education or increasing the financial incentives to save (e.g., the employer match or the tax deductibility of savings plan contributions)
- Success approaches to increasing retirement savings plan enrollment and contribution rates include automatic enrollment, automatic contribution escalation, simplified enrollment interfaces with default-like options, and planning aids.

Most of these approaches are most effective for the population groups that face the biggest barriers to taking action: employees who are younger and who have lower incomes, and members of traditionally disadvantaged racial and ethnic groups.

Despite the effectiveness of plan design features in changing retirement savings outcomes, there is still a role for effective plan communication in helping employees understand their benefits and personalize their retirement contributions and/or asset allocation.

Four lessons that I have learned from my own research and that of others on retirement savings plan communications are:

- **1: Keep it simple**. In a study entitled "Simplification and Savings," my coauthors and I analyzed an intervention that provided employees at two large companies with an extremely easy way to either enroll in their employer's savings plan or to increase their savings plan contributions: a postcard-sized reply form with a simple check-box to make the change. These simple communications generated about a 10 percentage point higher response rate than the business as usual communications typically sent out by these firms to non-participating.

- **2: Do it again**. One of the firms in the above referenced study sent out a similar mailing to non-participating employees each year. At this firm, savings plan participation for employees targeted by the intervention increased by 10 percentage points relative to baseline trends after the first mailing; in addition, there was an additional increase a year later after the second mailing and another increase two years later after the third mailing. After three mailings, 45% of non-participating employees had signed up for the savings plan, a doubling relative to the 22% who enrolled in the savings plan over a similar time frame before the company adopted the simplified communications approach to savings plan enrollment described above.

- **3: Make it actionable**. In a study of the mandatory personal financial management course required by the army for all new soldiers, Bill Skimmyhorn, a former student of mine, finds sizeable increases in Thrift Savings Plan participation as a result of combining financial education with the ability to fill out the required enrollment forms before leaving the classroom. In the previously referenced studies on simplification and savings outcomes, the simplified enrollment forms sent in the mail to employees included a postage pre-paid reply form—no need to even find a stamp! Small barriers—tracking down a form, or finding a postage stamp, can impede action, so combining communication with easy ways to take action will likely be more effective at changing outcomes than communication alone.

- **4**: **Capitalize on existing decision moments**. We often talk about people being short on money. People are also short on attention. Getting employees to focus on retirement savings can be difficult, but it may be easier to direct their attention that way once you already have it. New employee orientation, annual enrollment for health benefits, and the personal financial management training course described above are all occasions when you employers have the attention of employees. Strategies that capitalize on this attention can be very effective. For example, handing out simplified enrollment forms at new employee orientation is more effective than mailing them to employees' homes. There are many strategies employers could use to redirect attention to their retirement savings plans.

But even an extremely effective communications strategy does not obviate the need for better plan design. In another study on investment choices, this one experimental, we asked subjects to allocate a hypothetical $10,000 across four different S&P 500 index funds ("Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds"). We find that when employees have only the mutual fund prospectuses to help them in their investment choice, they do a poor job at identifying the lowest fee investment. When we provide them with a simple one page sheet that explains what mutual fund fees are and compares the fees charged for the four investment options in the experiment, subjects do a better at picking a low fee portfolio, but most are still unable to minimize portfolio fees. One conclusion from these results is that more effective communication can help improve behavior, but it is not a panacea. For example, giving savings plan participants information about investment fees will not impact portfolio fees as much as having plan sponsors choose low fee funds for the investment menu.

I would like to conclude with some additional thoughts on changes, both large and small, that could help improve retirement savings outcomes in the United States:

- **1: Coverage**. Only about half of employees work for firms that offer a retirement savings plan, yet we know that payroll deduction is the most effective way to help employees save for retirement. Expanding the availability of workplace-based savings plans is the single most important step we can take to increase retirement income security in this country. On this front, there are both regulatory and non-regulatory barriers to action. Most of the employees who do not have access to a workplace savings plan are employed at small firms. Providing a retirement savings plan may not be the highest business priority to owners of these small firms. Here, too, small barriers can create large impediments to action. Some changes that might increase the utilization of payroll deduction for retirement savings include: (1) allow small firms to transfer the fiduciary responsibility of offering a workplace savings plan to entities better able to bear the risk, for example, large financial service firms, (2) allow small firms to create and participate in multiple employer sponsored savings plans, for example, a plan sponsor by the local Chamber of Commerce for small employers in a given locality, (3) require or provide incentives to encourage small firms to give their employees the option of participating in an auto-IRA.
- **2: Leakage**. Many employees take money out of their retirement savings plans well before they reach retirement. The problem in aggregate is non-trivial. If individuals are using retirement savings plans for current consumption needs as well as to finance their retirement, the contributions rates necessary to ensure retirement income security will need to be higher than they are without leakage from the system. There are two solutions: reduce leakage, or increase savings plan contributions.
- **3: Turning wealth into retirement income**. Increasing annuitization of retirement wealth, both in defined benefit savings plans, which increasingly allow for a lump sum option, and in defined contribution plans, which typically do not even have an in plan annuity option.

- **4: Non-match financial incentives**. In defined contribution savings plans, the only financial incentive allowed for by law is the employer match. But allowing for other types of incentives could be one way to motivate employees to take action. For example, in plans without automatic enrollment, a low cost way to encourage early savings plan enrollment would be to allow plans to give employees a gift card to a local restaurant or something similar if they sign up for the savings plan within the first 30 days of enrollment. Plans could encourage employees to increase their contribution rate by entering all employees who do so during open enrollment into a lottery for an iPad. Such incentives are a low cost way to capture attention and motivate behavior change, but they are currently not allowed under the law.

I am hopeful that we can continue to improve the regulation of our retirement saving system in ways that will help promote the long term retirement income security of all Americans.

Thank you for the opportunity to speak to you today. I am happy to try and answer any further questions you might have.

References

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