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"Improving Communications around Employee Options to Withdraw Savings Plan Balances Before Retirement"

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 Kennedy School 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. Today I'd like to share my thoughts on how employers can improve the decision-making of their employees around leaving retirement savings plan balances in the tax-favored retirement system vs. taking those balances out as a cash distribution before retirement.

We know from a large and growing body of literature that many individuals lack financial literacy and, as a consequence, make mistakes when confronted with complicated financial decisions in a variety of domains, including retirement savings. The best course of action about whether or not to take a loan or a hardship withdrawal, or to take a cash distribution following a job termination versus rolling over balances into an IRA or another employer's plan, depends on a variety of factors and there is no single "best" answer.

It is not surprising then that employees often make decisions that they later regret. In a survey conducted by Warren Cormier for Fidelity investments a few years ago, defined contribution plan participants were asked if they had ever taken out a loan from their savings plan, taken a hardship withdrawal, or taken a cash distribution. Those who answered yes were then asked if they would make the same decision again if they had it to do over again. The results are quite telling and speak to significant regret:

- Of those who had taken out a loan, 29% reported that they would not do it over again
- Of those who had taken a hardship withdrawal, 39% reported that they would not do it over again
- Of those who had taken a cash distribution, 55% reported that they would not do it over again

I find it interesting that the magnitude of the regret is correlated with, and increasing, in the financial magnitude of these different actions. The regret is largest for the decisions that have the largest long-term impact on retirement plan balances.

How can plan sponsors help participants make decisions about their retirement savings balances that will improve retirement security? I offer a few suggestions based on my research and that of others on factors that impact financial decision making.

- In addition to the legal department, the marketing department should be involved in designing any communications with employees about how they should evaluate options around taking money out of the plan, either through a loan, hardship withdrawal, or a cash distribution. We have an entire advertising industry dedicated to designing effective ways to communicate with consumers. Their approaches never look like what comes out of a corporate legal department. To be effective, communications need to be both accurate (the job of the legal department) ***and*** they have to capture and retain individual attention (the job of the marketing department). Effective print-based communications make use of graphics, color, lists, simple comparisons, varied fonts, and so on.

- Interactive web- or app-based decision tools could be helpful. For example, such tools could better help employees assess the long-term impact of keeping money in a current employer's plan given the fees in that plan vs. rolling money into an IRA under the control of a financial advisor charging a hefty management fee.

- One lesson that comes out of the behavioral science literature is that how information is presented matters. Individuals are looking for reasons to make or reject particular courses of action. For example, in the case of what to do with retirement plan balances following a job termination, some presentational strategies that would encourage individuals to leave money in the retirement savings system include:

    (1) List the option to take a cash distribution last, after the options to leave money in the plan or roll money into another employer's plan or into an IRA.

    (2) In describing the factors that would impact making one choice vs. another, start with the factors that favor leaving money in employer plans first. Individuals are likely to experience fatigue as they go through any communications around these issues, so it makes sense to give priority to those factors that support the options that facilitate long run retirement security.

    (3) Use lists and charts to facilitate comparisons and highlight things that are similar vs. things that are different across the relevant set of options.

    (4) Provide individuals with data on the experiences other people have had when confronted with the same decision. In research on payday lending disclosures, providing borrowers with information on just how many people end up renewing their loans rather than paying them off reduced subsequent loan utilization (Bertrand and Morse, 2011). Highlighting the statistics on future regret about decisions to pull money out the savings plan that I described earlier could have a similar impact on whether employees take a cash distribution from their savings plan. Telling individuals how many people pay higher fees when they roll their balances from an employer plan into an IRA could impact the IRA rollover decision. Informing employees about the fraction of individuals who end up defaulting (and subsequently paying tax penalties) on their 401(k) loans could

help employees better assess decisions and whether or how much to borrow from their savings plan.

- Finally Department of Labor could design and field test both print-based and interactive web-based decision tool prototypes to compare them against standard communications, much in the same way that the CFPB has been field testing mortgage disclosure and other communications. I suspect that there is significant room for improvement over existing disclosures and other communications, but the only way to effectively illustrate this and motivate change is to measure the impact of doing something better, and then publicize this fact. Being able to show that improved communications have a measurable impact on decision outcomes would help propel companies and plan sponsors to redesign their own communications. First, because they would understand that they can have an impact by doing things differently. Second, because with an effective prototype, they do not need to completely reinvent the wheel. And third, because some compliance officers would prefer to follow prototypes put out by regulators than go it alone.

Beyond communications initiatives, we know from much other research on financial decision making that individuals are more likely to do things that are easy, and less likely to do things that are difficult. Taking a cash distribution is easy and often involves less time and effort than effecting a rollover into another employer's plan or an IRA. Establishing a clearinghouse mechanism to facilitate rollovers from one employer's plan to another could help employees who would prefer to have their retirement savings consolidated (a preference that it is hard to disagree with) do that through a new employer's plan than through a potentially more expensive and less regulated IRA.