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**What’s Inside:**

Top Ten Best Practices ..... 1

Introduction..... 3

Financial Literacy and Worker Knowledge of the Value of Retirement Savings Plans..... 4

Automatic Enrollment ..... 7

The Importance of Employer-Provided Information ..... 9

References ..... 12

Resources..... 12

About this Publication ..... 13

About the FINRA Investor Education Foundation..... 13

About FINRA ..... 13

## How Employers Can Help New Hires Save for Retirement: Best Practices that Build Long-Term Financial Security

### Top Ten Best Practices

Not all employer-sponsored defined contribution retirement savings plans are created equal—some employer practices and plan designs are more successful than others in helping new hires accumulate a robust retirement nest egg. We reviewed numerous studies conducted by researchers affiliated with the Financial Literacy Center, and have identified ten powerful—and often relatively easy—ways to increase financial literacy among newly hired employees, enhance their ability and willingness to participate in and contribute to retirement plan accounts, and improve their overall financial well-being. The guidance offered in this report is based on information derived from studies of real people in real situations and examination of how their behavior is affected by workplace policies and practices.<sup>1</sup>

- 1. Equip new employees with basic retirement plan information.** When new employees understand the fundamentals of their employer-sponsored retirement plan, they are more likely to participate in and contribute to the plan. As such, the information that employers provide to employees is critically important. Studies tell us that many people, when surveyed, are unable to identify the type of retirement plan they have, raising concerns that individuals in the workforce don’t know the fundamentals regarding retirement plan options. When offering plan information to employees, for example when they are first hired, start with the basics. Make sure employees understand their plan and plan offerings:
  - ▶ What type of plan is this?
  - ▶ How does it work?
  - ▶ What features (such as matches, ability to borrow, ability to roll prior employer or IRA plans into the account, etc.) and investment choices does it offer?

<sup>1</sup> These best practices are based on a series of research studies conducted by affiliates of the Financial Literacy Center (FLC). See the [Resources](#) page for relevant links mentioned in the body of this report. Research papers and informational materials from these studies can be accessed on the FLC website: [www.rand.org/labor/centers/financial-literacy.html](http://www.rand.org/labor/centers/financial-literacy.html). Financial support from the Social Security Administration and FINRA Investor Education Foundation is gratefully acknowledged.

- ▶ What decisions does the employee need to make? And by when?
- ▶ What elements of the plan can employees customize to meet their own needs and best interests?

Be sure to use plain language and clearly explain common retirement plan terminology such as “vesting” or “supplementary retirement account.”

- 2. Focus on key concepts to improve employees’ overall financial literacy.** Improving worker knowledge of a few specific fundamental concepts—such as the importance of interest compounding, investment diversification, and the eroding effect of inflation—can significantly improve retirement planning decisions. There are simple tools that can help to do this: for example, informational videos, visual tools, and online games (see [Resources](#) page). Moreover, assisting new hires to better understand tax advantages, the importance of contributing early in one’s career, and key aspects of investing will help them to make better financial decisions.
- 3. Tailor financial information and educational programs to meet the needs of employees.** Research shows that financial information is more effective when it is customized to the needs of specific groups; targeted programs are more effective than one-size-fits-all information. General, untargeted information can even be counterproductive, discouraging some workers from saving. Use one-on-one meetings or small group sessions—of, for example, women in your workforce, young workers for whom this might be their first job, or workers who are nearing retirement—to discern the varied needs of your workers and empower them to make the financial decisions that best serve those needs. Any information provided to the employee should be relevant to someone of that age, gender, and career stage. Research shows that there are sharp gender and age differences in financial literacy, with women demonstrating lower financial literacy than men and with young people showing consistently low levels of financial literacy. But within and outside of these groups, individuals’ needs will vary depending on debt holdings and other personal characteristics.

- 4. Recognize that debt management and retirement savings go hand in hand.** Debt and debt management are increasingly important determinants of lack of participation in and contribution to retirement plans; employees would benefit from reducing any high-interest debt before making substantial contributions to retirement accounts. One hundred percent plan participation within a company or firm does not always equate with improvement in the financial well-being of all employees. Employers who help employees manage their current debts will enhance the ability of those employees to make contributions to retirement plans in the future.
- 5. Offer an employer match.** The employer match provides an important incentive for workers to enroll in the firm’s retirement plan and to contribute up to the full match rate. Make sure that employees know about the match, understand what they need to do to be eligible for it, and understand any vesting restrictions on it. Research finds that workers tend to contribute at a level that equals the maximum amount matched by the employer. This maximum employer match can be construed as an implicit recommendation for the appropriate level of employee contributions, even if this is not the case.
- 6. Use automatic enrollment to boost participation rates.** Automatically enrolling new hires in retirement savings plans has been shown to substantially increase participation in and contributions to 401(k) and other types of defined contribution plans. Many studies, including recent research by the Financial Literacy Center, have shown that the adoption of automatic enrollment increased participation in retirement savings plans to over 90 percent of newly hired employees. This is a powerful way to promote participation among different types of workers, even those with low income.
- 7. Set a default savings level that (at minimum) meets the employer match rate—and consider escalating this amount over time.** The inertia that often leads to low participation rates can also cause workers to stick to the pre-determined contribution rate associated with automatic enrollment. Thus, careful consideration of the minimum default rate is critical. That rate should at least meet the full

employer match, and employees should be made aware of whether (or not) the default level is likely to result in high replacement income in retirement and how and when they can make changes to their contribution rate. Implementing automatic escalation can help avoid the problem of inertia and help employees accumulate a sizeable nest egg.

**8. Provide sound financial information and counseling to employees.**

It may not be in the best interest of all newly hired employees to have their take-home pay reduced by retirement plan contributions. Providing appropriate financial information and counseling helps workers to consider the value of retirement contributions in relation to other needs and savings motives. Simple financial advice and counseling about interest rates on credit cards, student loans, and other debts would help new employees consider the value of paying off debt versus making contributions to retirement plans. Moreover, building up a stock of savings will help employees shield themselves against financial shocks. Employers could require the providers of their retirement savings plans to supply such unbiased information and counseling.

**9. Remind employees about investment risk.**

Employees have to decide not only how much to contribute but also how to allocate their retirement investments. Research from the Financial Literacy Center shows that most employees lack knowledge about the workings of risk diversification. In fact, of the financial literacy concepts that have been assessed in recent research, this is the concept that consistently presents the most difficulty. Therefore, even when contributions are being directed to target or life cycle funds, employees would benefit from basic guidance to enhance their understanding of what these funds do and the composition of risky assets in these funds. Moreover, as the financial crisis has shown, poor asset allocation in other, non-retirement assets may offset the benefits of well-diversified retirement assets and hinder retirement well-being.

**10. Regularly remind employees of the value of a retirement plan.**

Research shows that providing new hires with regular and timely reminders of the value of contributing to the company retirement plan can increase retirement savings. There are

specific times that can be teachable moments: at annual reviews, following a promotion, at match eligibility, or upon being vested in other pension plans, as well as at individual life events (marriage, for example, or the birth of a first child) that might lead workers to alter other benefits, such as health insurance plan options.

## INTRODUCTION

The current trends in public and private retirement benefit programs mean that workers entering the labor force must assume greater responsibility in providing for their own retirement income. For many Americans, the most effective and easiest method of saving for retirement is through payroll contributions to retirement accounts such as 401(k), 403(b), and 457 plans. There are many advantages to contributing to these accounts. First, because they are tax-favored accounts, contributions earn higher rates of return, thus leading to larger accumulation. Second, they are easy-to-use savings vehicles, with funds transferring directly from a paycheck to the account. Third, any employer match provides immediate and significant rates of return on investment. Yet, notwithstanding these advantages, participation in and contribution to retirement accounts are low among workers who are eligible for employer-sponsored retirement savings plans.

This report explores reasons for low levels of plan enrollment and ways that program design and employer action can increase participation and contribution. The analysis focuses on three major factors that directly influence participation and contribution decisions: (1) financial literacy and worker knowledge of the value of 401(k) and other defined contribution plans; (2) specific plan provisions such as automatic enrollment and employer match rates; and (3) employer-provided information. This report reviews the findings of a set of rigorous research studies conducted in conjunction with the Financial Literacy Center. The findings from these studies are placed in the broader context of other research that has examined retirement savings in order to illustrate how employers can influence retirement saving behavior. The analysis provides specific recommendations that

can be applied by employers to enhance retirement saving by newly hired workers. We focus on newly hired workers because, whether they are young people just joining the labor force or—given the increasing mobility of the workforce—older, experienced workers who are changing jobs, they are required to make important financial decisions when newly employed. The fact that these decisions are so critical and are happening with greater frequency increases the importance of paying attention to employee decision making upon beginning a new job.

## I. THE IMPORTANCE OF FINANCIAL LITERACY AND WORKER KNOWLEDGE OF THE VALUE OF RETIREMENT SAVINGS PLANS

As predicted by basic models of saving, the decision by newly hired workers to enroll in their employer's 401(k) (or other defined contribution) plan is influenced by personal preferences and needs and the characteristics of the plan. For young people, the need to purchase items associated with starting out in life (car, house, consumer durables, and the like) may result in favoring current consumption over saving for retirement. In addition, many employees begin a new job with substantial debt, such as student loans and credit card bills. As documented by the 2009 National Financial Capability Study (NFCS), the young—those just entering the workforce—are those most likely to carry credit card debt and are more likely than older individuals to rely on high-cost methods of borrowing, such as payday loans and rent-to-own contracts.<sup>2</sup> Faced with debt obligations, some with high interest rates, individuals have to determine whether paying off these debts is more efficient in building wealth over the long run than immediately beginning to make contributions to

a retirement savings account. Moreover, young workers may need to build up a buffer stock of savings to insure against emergencies. They may also need to save for a down payment for a house and a car to avoid engaging in high-cost mortgages and loans.

Do these barriers to retirement saving overcome the value of contributing to retirement plan accounts? In some cases, yes. If an employee has high-interest debt, that may need to be taken care of before making contributions to a retirement account. But in other cases, no. Because of preferential tax treatment and the value of the employer match, the value of saving through a company retirement plan can be greater than paying off a long-term, low-interest school loan. In other words, one size does not fit all when considering new hires.

While government and company policies regarding retirement savings vehicles should (and do) provide, in principle, a strong incentive for workers to participate in their employer's retirement savings plan, employees must be aware of and understand the value of tax advantages and employer matches if these benefits are to incentivize plan enrollment.<sup>3</sup> Appreciation of the power of interest compounding and the value of regular monthly contributions and a well-diversified portfolio is often lacking among employees. Providing information at critical times can be a means for improving participation in and contributions to retirement accounts. Information to boost employee understanding of the value of available plans can consist of reminders of the employer match and its immediate return on employee contributions, the value of the tax treatment of saving through employer retirement plans, and the power of compounding rates of return over a career.

A 2011 study based on a survey of newly hired workers, aged 18 to over 60, at four large companies examined reasons for nonparticipation in the company 401(k)

<sup>2</sup> See Lusardi (2011).

<sup>3</sup> See Gustman, Steinmeier, and Tabatabai (2008) for a detailed discussion of employees' knowledge of their company pension plan.

plan and for levels of employee contributions below the employer match rate.<sup>4</sup> Surveys were sent to new employees approximately 60 to 90 days after date of hire to ensure that they had sufficient time to enroll in the 401(k) plan prior to responding to the survey. Of those surveyed, two-thirds were currently contributing to the retirement savings plan, and the average contribution amount of those participants was slightly less than 6 percent of salary.

In general, respondents indicated that more and better information concerning the employer retirement plan, the key parameters of the plan such as employer matches, and the importance of saving for retirement might have influenced their decision to start contributing to the plan. This finding suggests that employers might increase participation rates by providing additional information about the retirement plan when employees become eligible for the employer match. Approximately 30 percent of respondents indicated that they would have benefited from additional information provided by the employer or the vendor of the 401(k) plan. Over one-third of respondents reported that the information they received influenced their decision to participate in the voluntary retirement savings plan. The survey also indicated that the most common reason given for non-participation had to do with employer match eligibility. In most companies, employees can begin participating in the company 401(k) plan at the time of hire, but many plans do not offer an employer match until the employee has attained a certain length of service, often one year. Half of respondents not currently contributing to the plan stated that they would begin to contribute once they became eligible for the matching contributions.<sup>5</sup> Providing basic information around teachable moments could stimulate greater retirement saving behavior among new employees.

The most common reason found for low contribution levels among those currently enrolled in a plan was

budget constraint, *i.e.*, the need to finance daily expenditures.<sup>6</sup> Other reasons cited for limiting 401(k) contributions were paying off student loans and mortgages, paying off credit card debt, and—as mentioned above—not being match eligible. These findings indicate the importance of listening to employees' needs. Employers should recognize, for example, that young, newly hired employees often are dealing with debt and debt management. Employers must understand that these needs and preferences impact employees' decisions to save for retirement.

These findings are echoed in qualitative research (focus groups and in-depth interviews with employees) conducted via a similar study at a not-for-profit institution. Many of the employees of that institution cited debt as an impediment to enrollment in Supplementary Retirement Accounts (SRAs). Others simply stated they “did not know where to start.” Additionally, many considered themselves unsophisticated investors.<sup>7</sup>

Several studies have documented widespread lack of financial literacy among the population. Lack of knowledge of concepts that form the basis of financial decision-making, such as interest compounding, inflation, and risk diversification, is particularly severe among young respondents (age 23–28). Only about one in four young respondents displays a sound grasp of basic financial knowledge.<sup>8</sup>

Similar findings are reproduced when assessing financial knowledge among workers in the large firms examined above. Knowledge about the workings of interest rates, inflation, investment, and employer matches is lacking among a sizeable share of workers. Moreover, just over one-third of those surveyed were able to correctly answer a question assessing their understanding of the tax advantages of participating in a 401(k) plan.<sup>9</sup> Notably, financial literacy and knowledge of the 401(k) plan were greater among

<sup>4</sup> See Clark, Morrill, and Maki (2011).

<sup>5</sup> Among those who were contributing to the plan, 59 percent stated that the match was “very important” to their decision to enroll in the plan and another 16 percent indicated that it was “important.”

<sup>6</sup> See Clark, Morrill, and Maki (2011).

<sup>7</sup> See Lusardi, Keller, and Keller (2008).

<sup>8</sup> See Lusardi, Mitchell, and Curto (2010).

<sup>9</sup> See Clark, Morrill, and Maki (2011).



plan participants than among those who were not currently enrolled in the plan. For example, there was a 17 percentage point difference in the knowledge about the effects of inflation between those who participated in the plan and those who did not participate. Thus, enhanced financial literacy may increase participation in employer-sponsored 401(k) plans.

More formally, the relationship between financial literacy and retirement planning has been documented in several Financial Literacy Center studies using data from nationally representative samples that show that those who have higher financial literacy are more likely to plan for retirement and consequently more likely to accumulate higher amounts of wealth. This finding has now been reproduced in many other countries.<sup>10</sup> Retirement planning can be enhanced in simple ways. In an experiment on a representative sample of the US population, individuals were exposed to five short videos explaining in simple terms the concepts of interest compounding, inflation, risk diversification, tax-favored assets, and employer matches (see [Resources](#) page). Compared to a control group who did not get any education, those who were exposed to these informational videos were found to have increased their knowledge and their capacity to answer hypothetical questions about saving decisions. For example, the difference in the knowledge of risk diversification, tax benefits of retirement accounts, and the benefits of employers' matches between the two groups (measured by the proportion of correct answers) was on the order of 10 percentage points. While these videos were targeted to young adults, older respondents who viewed them also increased knowledge and capacity to correctly answer questions concerning saving decisions.<sup>11</sup>

Other insights are offered by a survey documenting that half of the population in the United States—and a much higher proportion of young respondents—could not come up with \$2,000 in 30 days if faced with an

unanticipated expense.<sup>12</sup> This indicates that there are a substantial number of people who could be unable to repair a car or deal with another financial emergency that might prevent them from getting to work. Moreover, if lack of liquidity induces young workers to engage in low-down-payment mortgages or high-cost methods of borrowing, as documented in the National Financial Capability Study, their financial stability, on average, may deteriorate even if they have money in retirement accounts. These findings have important implications for employers as they plan their strategies for increasing participation in retirement savings plans. Any initiative for encouraging contributions to retirement savings plans must take into account new workers' overall financial situation and the need to manage debt as well as start to save for retirement. All of these concepts have been incorporated in the workplace financial fitness toolkit of the New York Stock Exchange (see [Resources](#) page), which was developed by researchers from the Financial Literacy Center.

These findings and the studies reviewed in this section offer a series of observations that employers should consider in reviewing their retirement savings plans:

- ▶ Employee knowledge of retirement plans and of critical aspects of those plans should not be taken for granted; employees often do not even know which type of plan they have. Providing information and clear communication about key aspects of the plan is not only needed but will increase the appreciation of the benefits the company offers.
- ▶ The level of financial literacy in the population is low. Yet financial decisions necessary for setting up sound financial plans—adequate for retirement replacement income—require an understanding and appreciation of the incentives provided by both the government and the employer. Employers can help boost employees' financial literacy by providing regular financial education sessions and offering

<sup>10</sup> See Lusardi and Mitchell (2011a,b). In several countries and in studies like Lusardi and Mitchell, 2009, it was possible to show that the relationship is causal; it is financial literacy that causes higher levels of planning and not the other way around.

<sup>11</sup> See Heinberg et al. (2010).

<sup>12</sup> See Lusardi, Schneider, and Tufano (2011).

relevant information at teachable moments. In addition to clearly and succinctly explaining the fundamentals of any plan offerings, information should cover the concepts at the basis of financial decision-making: interest compounding (as it relates both to debt and to saving/investing); inflation (as it impacts retirement saving); and risk diversification (as it relates to selecting a diversified portfolio).

- ▶ Consumption needs, saving motives other than retirement, and debt payments limit the ability of many new employees to fully participate in retirement savings plans. Employers should not expect a 100 percent, or even a very high, participation rate, but providing financial literacy programs would help workers better manage these competing demands, and lead ultimately to increased retirement plan participation.
- ▶ A better understanding of the value of contributing to 401(k) plans is key to increasing participation and contribution rates. Employers should recognize the importance of financial literacy to retirement saving decisions and assist employees in improving their understanding of tax advantages, importance of contributing early in one's career, and key aspects of investing.
- ▶ The employer match provides a very important incentive for workers to enroll in the 401(k) plan and to contribute up to the full match rate; thus, employers should pay especially close attention to this component of the plan. For example, do employees have to attain a certain length of job service before they are eligible to enroll in the plan or eligible for the employer match? The shorter these tenure requirements are, the more quickly new workers will begin to save for retirement. The amount of the employer match is critically important. Matching at a low rate, such as 3 percent, will only offer an incentive to contribute at a relatively low rate of pay, which might prevent

employees from accumulating a sizeable nest egg. There are many differences among workers, and what is best for them depends on their individual circumstances. However, employer matches provide the capacity, vehicle, and the incentive for employees to save and may also serve as information on the minimum amount that an employee should contribute to his or her retirement savings account.

- ▶ Using communication methods that facilitate the transmission of information, such as videos or jargon-free text, can enhance understanding of the value and benefit of a company retirement plan, particularly for individuals with low financial literacy.

## II. AUTOMATIC ENROLLMENT IN EMPLOYER-SPONSORED RETIREMENT SAVINGS PLANS

Studies in behavioral economics have emphasized the impact on participation rates of factors such as inertia when individuals need to be proactive in order to enroll in an employer-sponsored retirement savings program.<sup>13</sup> To make inertia work *for* rather than *against* employee financial well-being, employers can change plan design so that newly hired employees are automatically placed in the retirement savings program, with the option to opt out. If inertia plays a central role in low participation rates, then adoption of automatic enrollment policies should increase retirement savings.

Since the passage of the Pension Protection Act in 2006, an increasing number of companies have begun to integrate automatic enrollment features into their 401(k) and other retirement savings plans. When an employer adopts automatic enrollment, employees—new hires, existing hires, or both—are enrolled in the

<sup>13</sup> See Madrian and Shea (2001).

retirement plan at a default contribution level and into a default investment option. A common default contribution rate is 3 percent of salary, and a common default investment is either a target date fund or other balanced fund. The new employee has the option of withdrawing from the plan (opting out) or changing the contribution rate or investment option at any time.

Several studies have examined the impact of adopting automatic enrollment on retirement saving.<sup>14</sup> These studies find that automatic enrollment immediately increases participation rates of newly hired workers.

Using data from several large firms, a recent study from the Financial Literacy Center compared the participation rates of four companies, two with automatic enrollment policies, and two without.<sup>15</sup> The proportion of new hires enrolled in the 401(k) plans was significantly higher in the two companies with automatic enrollment. In these companies, participation rates exceeded 90 percent of all newly hired workers.

But when it comes to helping new hires maximize savings for retirement, automatic enrollment alone isn't enough. Numerous studies make clear that auto-enrollment is best combined with robust default contribution levels, either at the time of enrollment or over time through automatic escalation, and with a healthy dose of investor education.

One of the firms in the study mentioned above provided the researchers with data on new hires before and after the introduction of automatic enrollment. The following discussion reviews some key findings. In December of 2007, the company's 401(k) plan adopted a policy of automatically enrolling new hires into the plan at a contribution rate of 3 percent of pay. The 401(k) plan was the primary employee retirement savings vehicle, and there was no defined benefit plan offered. For workers with at least one year of service, the employer matched 100 percent of the first

4 percent saved and 50 percent of the next 2 percent saved. The researchers examined data on participation and contribution for two years prior to the adoption of automatic enrollment and for two years after the adoption of this policy.

Prior to the introduction of automatic enrollment, only about 60 percent of newly hired workers were participating in the retirement savings plan. In comparison, the participation rate exceeded 90 percent among those hired after the implementation of automatic enrollment. Thus, as seen in many other studies, the adoption of automatic enrollment substantially increased the proportion of newly hired employees who were enrolled in the 401(k) plan at this firm. However, a large percentage of those who were automatically enrolled in the 401(k) plan contributed at the minimum default rate of 3 percent of pay—a rate below the level that would allow them to receive the full benefit of the employer match (6 percent). In other words, more workers contribute to retirement accounts in the presence of automatic enrollment, but the rate at which they contribute can be rather low.

Another recent study examined the effects of automatic enrollment legislation in South Dakota and its initial impact on participation rates in the state's defined contribution retirement plan. While prior to the policy change only about 20 percent of all eligible employees participated in the supplemental retirement plan, eight months after the passage of automatic enrollment legislation, 91 percent of new, eligible employees whose units chose to implement automatic enrollment participated in the plan and remained in it.<sup>16</sup>

Other recent work also shows that defaults are particularly "sticky,"<sup>17</sup> meaning that workers stay at the default rate even when it can be shown it is not a good choice for them. This is particularly the case for employees with low income and low education, characteristics that are associated with low financial literacy.

<sup>14</sup> Madrian and Shea (2001) and Beshears et al. (2008), among others.

<sup>15</sup> See Clark and Morrill (2010).

<sup>16</sup> The business case for and other resources on automatic enrollment can be found at the website [www.retirementmadesimpler.org](http://www.retirementmadesimpler.org).

<sup>17</sup> See Beshears et al. (2012).



This example again illustrates that while auto enrollment is an excellent tool for boosting enrollment numbers, it doesn't necessarily lead to workers making smarter choices, including optimizing the amount being saved and investment allocation of those savings. A combination of good plan features and worker knowledge of how to make the most of their plans is important. In terms of investment, numerous quantitative and qualitative studies show that employees lack knowledge of risk and risk diversification and consider themselves simple investors. This is particularly the case for female employees.<sup>18</sup> An example of a customized workplace financial education program that incorporates automatic enrollment and automatic escalation but provides a richer set of initiatives to foster employees' financial security is that of the New York Stock Exchange Foundation (see [Resources](#) page).

To summarize the main findings:

- ▶ The adoption of automatic enrollment is associated with a substantial increase in retirement savings plan participation rates. Thus, this easy-to-implement policy should increase the ability of workers to accumulate retirement assets.
- ▶ Consistent with the effect of inertia, workers who are automatically enrolled at the minimum default contribution rate tend to stay at that rate. This is cause for concern if the default rate is insufficient to accumulate adequate retirement savings. Employers should consider an initial default rate that at least attains the level of any available match—combined with automatic escalation in which the default contribution rate gradually increases to higher levels of saving.
- ▶ Employers should recognize that it may not be in the best interest of all newly hired employees to have take-home pay reduced by contributions to retirement savings plans. Providing financial information and counseling can assist workers in

understanding the value of retirement contributions in the context of their overall financial profile, including the need to reduce any existing debt.

Even the best automatic plan designs—including automatic enrollment, robust default savings levels, and auto-escalation—can be made even better by incorporating sound financial education and communication. In the next section, we'll discuss the importance of employer-provided financial information, the goal of which should be increasing employees' financial literacy and knowledge of saving plans, enabling them to make the best possible retirement saving choices.

### III. THE IMPORTANCE OF EMPLOYER-PROVIDED INFORMATION

If employees fail to save because they face budget constraints or determine that it is in their best interest to forgo a saving opportunity at the present time, it may be difficult to increase retirement plan participation. However, if low participation rates are the result of lack of knowledge and information, an intervention addressing these barriers may increase participation. Similarly, as argued throughout this report, for many people, it might be important to first address other saving needs before contributing to a retirement savings account. However, if lack of saving results simply from inertia or a lack of understanding of the benefits offered by their employer, then information to address these barriers might increase participation.

To examine the impact of information (and low-cost interventions as well), a large field experiment was designed to test whether employer-provided financial information could be effective in increasing 401(k) plan participation among employees at a large national employer.<sup>19</sup> All employees hired during 2008 through

<sup>18</sup> See Lusardi and Mitchell (2011b) and Lusardi, Keller, and Keller (2008).

<sup>19</sup> Clark, Morrill, and Maki (2011).

2010 who were not participating in a retirement plan as of February 2011 were randomly assigned to three groups. The first group received a flyer that included a brief example of investment growth over time and instructions on signing up for the company's 401(k) retirement savings plan (see [Resources](#) page). The second group received the same flyer but, in addition, were provided a statement about the company-wide participation rate (added to test for peer effects, that is, whether individuals change their behavior based on knowledge of what their peers are doing). The third group was the control group and did not receive the flyer or any additional or new information about participation in the company's retirement plan. The interventions were designed to highlight the benefits of saving, in particular the potential for investment growth over time. The information was distributed by the employer through the office email system, keeping costs low and distribution simple. Nearly 4,000 workers were part of the experiment, allowing for the exploration of differences in responses by demographic characteristics.

The flyers were distributed by the employer directly to employees in mid-April 2011. The researchers were given access to administrative data that allowed them to observe participation in the 401(k) plan before and after workers received the informational flyer. The increase in participation among those who received the flyer was 15 percent greater than for those in the control group, but there were no differences in the responses to the flyer with and without the peer effect information. Looking at results by employee age revealed notable differences in responses. Very young workers (aged 18 to 24) who received the flyer were twice as likely to join the 401(k) plan than those in the control group. A similarly large difference was observed for workers aged 35 to 44. It is important to remember that these were workers who had chosen *not* to enroll in the 401(k) plan upon being hired. Interestingly, workers aged 45 years and older receiving the flyer were 4.5 percentage points *less* likely to initiate participation relative to the control group.

This age pattern is worthy of consideration and helps to emphasize the importance of tailoring financial information to its recipients. The flyer that was

distributed was designed to help those who are more likely to be financially illiterate realize how valuable retirement contributions can be, with an emphasis on the importance of beginning to save for retirement early in one's career. The information demonstrated the power of compounding of returns over time, showing the gain in retirement wealth over a 40-year career. It is possible that older workers were actually discouraged from participating in the 401(k) plan by the examples used in the study. These results emphasize the importance of pre-testing the value and effect of information to be provided to employees. Pre-testing can alleviate challenges like the one seen in the above-mentioned study in which information provided by the employer seems to actually discourage certain workers from saving.

The goal of a similar experiment carried out by Financial Literacy Center researchers was to understand how employees' decisions to participate in and contribute to retirement plans was affected by information about the correlation between retirement savings and post-retirement income. Understanding the relationship between savings accumulated during working years and target retirement income is difficult, requiring that one understand complex relationships among many variables, including contribution rates, investment returns, and retirement age. Employees at a large university were randomly assigned to either a control or a treatment group. The treatment group was sent a customized projection of the additional account balance and retirement income that would be achieved from additional hypothetical contribution amounts; these projections were customized based on the employee's current age (see [Resources](#) page). Nothing was sent to the control group.

Researchers found that workers in the treatment group were more likely to increase their annual contributions and their contribution rate than were individuals in the control group. The treatment group increased contributions by an average of \$68 per year more than the control group, or by an additional 0.17 percent of salary. While many in the treatment group did not make changes to their contributions, among those who did, savings increased by about \$800 per year more than those in the control group. Surveys conducted

following the intervention showed a lot of mitigating factors, including a tendency to procrastinate and liquidity constraints. Moreover, the survey showed an increased level of engagement in the treatment group. Specifically, workers felt better informed about retirement planning and were likely to have recently figured out how much to save.<sup>20</sup> Yet another intervention at a smaller university showed that a planning aid that provided simple but precise steps guiding new hires through Supplementary Retirement Account enrollment more than doubled enrollment in these accounts.<sup>21</sup>

These experiments illustrate the effectiveness of interventions—even low-cost informational ones—in increasing 401(k) participation and contribution among some groups. In conjunction with other findings presented in this report, the programs profiled here provide several concepts that employers should consider:

- ▶ Providing employees, at teachable moments, with regular and timely reminders of the value of contributing to the company 401(k) plan can increase the proportion of workers who begin to participate in the plan.
- ▶ Targeting information to specific demographic groups so that employees can relate to the information can increase plan participation.
- ▶ Providing specific steps for employees to follow to enroll in retirement plans or take advantages of employers' benefits will simplify taking action and overcome some of the inertia that affects saving behavior.

Without a doubt, employers play an important role in influencing how employees participate in and contribute to retirement accounts. It is important for employers to recognize the differences that exist among employees and take these differences into

account when developing retirement plan accounts and providing information related to participating in these accounts. Yet, despite these differences, there are fundamental guidelines applicable to all employees. Increasing employees' basic financial literacy—providing information that explains concepts at the basis of saving and investment decisions—will help individuals better understand the relationships among their financial decisions, enabling them to prioritize (for example paying off high-interest debt before starting to save for retirement), and motivating them to save early and invest wisely. Simplifying saving and investment decisions and making use of automatic enrollment are also important to help employees accumulate retirement savings.

The structure required to enable individuals to reach retirement with a nest egg sufficient to support them through their retirement years can be compared with the infrastructure that allows millions of people each day to safely travel the roadways that take them where they need to go. Licensed drivers have been taught the fundamental rules of operating a vehicle, and the corresponding skills and knowledge are reinforced through roadmaps and signs that offer information as drivers travel the roads. Every driver will invariably encounter unique situations requiring reliance on judgment acquired through learned skills, knowledge, and practice. Vehicles are becoming more sophisticated and highway systems more complicated, but it's not enough to think that individuals can put their car on autopilot and navigate successfully and safely through every situation they might encounter. Just as a critical misjudgment by an automobile driver can lead to a serious traffic accident, so a serious error in financial planning can lead to a crisis in retirement. Thus, it is important to equip employees with the structure and the skills that are needed to navigate today's complex new retirement system.

<sup>20</sup> See Shah Goda et al. (2012).

<sup>21</sup> See Lusardi, Keller, and Keller (2008).

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## RESOURCES

The resources offered here are intended to demonstrate the types of tools that might effectively be used in helping newly hired employees save for retirement. This list represents a sampling of materials that are available.

Flyer used to test effectiveness of employer-provided information:

[www.rand.org/content/dam/rand/pubs/working\\_papers/2011/RAND\\_WR892.pdf](http://www.rand.org/content/dam/rand/pubs/working_papers/2011/RAND_WR892.pdf)

Customized projection correlating retirement savings with post-retirement income:

[www.rand.org/content/dam/rand/pubs/working\\_papers/2012/RAND\\_WR873-2.pdf](http://www.rand.org/content/dam/rand/pubs/working_papers/2012/RAND_WR873-2.pdf)

Online games to teach and reinforce the skills needed for managing personal finances:

[www.financialentertainment.org](http://www.financialentertainment.org)

Videos illustrating the fundamental concepts behind financial planning for young adults:

[www.rand.org/labor/centers/financial-literacy.html](http://www.rand.org/labor/centers/financial-literacy.html)

Workplace Financial Fitness Toolkit, New York Stock Exchange:

<https://nyse.nyx.com/financial-literacy/financial-fitness>

Business case for and other resources on automatic enrollment:

[www.retirementmadesimpler.org](http://www.retirementmadesimpler.org)

Additional research on the topic of financial literacy can be found at:

[www.rand.org/labor/centers/financial-literacy.html](http://www.rand.org/labor/centers/financial-literacy.html)

For general information, tools, and resources on financial planning and decision making:

[www.mymoney.gov](http://www.mymoney.gov)

The President's Advisory Council on Financial Capability's "Creating Financially Capable Communities: A Resource Guide" deals with workplace financial capability:

[www.treasury.gov/resource-center/financial-education/Documents/Local%20Guide%20-%20Creating%20Financially%20Capable%20Communities.pdf](http://www.treasury.gov/resource-center/financial-education/Documents/Local%20Guide%20-%20Creating%20Financially%20Capable%20Communities.pdf)

Further materials are available from the authors upon request.

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