

March 12, 2019

Building Toward a Better Retirement: Choice Architecture and Plan Participants

By Laura Hohwald, QPA

Overwhelming. That's normally the first response plan participants give as to why they didn't start saving for retirement. HR professionals and retirement consultants have heard it before, "Too many options; too many decisions; I wasn't sure what these words even meant." Effectively helping plan participants prepare for retirement takes designing the message in a different way.

Choice architecture is a term used to describe how decisions can be influenced by the layout, order, and variety of the choices presented. This concept can be used to help steer retirement plan participants into better decision-making. Plan sponsors can use choice architecture to their advantage by improving how participants' choices are presented and by using smart default options.

An important first step is to consider what obstacles often prevent employees from joining a plan or increasing their savings. A white paper from Wells Fargo, *Driving Plan Health* says, "Knowing which plan features, communications, and digital tools are designed to address these various psychological barriers is an important first step and can help guide the selection of which features and tools to use."¹ The plans that have solved for these types of problems, leveraging design elements, usually produce the best retirement outcomes for their employees.

Make their first choice automatic

Automatic enrollment and annual re-enrollment can be used to overcome inertia of participants by automatically putting them into the plan when they first become eligible. The participants must take action to opt out if they do not want to participate; this often results in much higher 401(k) participation rates than plans which don't use automatic enrollment.

Retirement outcomes for participants can be further improved by implementing automatic deferral increases. This helps those participants who do not take initiative in managing their savings.

Finally, qualified default investment alternatives (QDIA) can be tailored to meet the needs and investment styles of different workforces. Offering QDIAs allows participants to accumulate far greater savings in the form of investment earnings than if they left their funds in cash or a stable return fund. In the article, *Choice Architecture and Participant Investment Decisions*, Vanguard notes, "Sponsors seeking to change behaviors of longer-tenured participants may wish to consider reenrollment into a low-cost default option, as that is one way to counteract the profound inertia influencing longer-tenured participants' investment holdings."²

Incentivize their saving goals

Once enrolled, there are many choices participants must make. How those choices are presented to them can make a huge difference in long-term savings. For example, the *Save More Tomorrow* program gives participants a nudge to save more by having them establish their own future defaults today. The defaults selected happen automatically in the future when a raise occurs, so the participant never has a decrease in take-home pay.³

Another common way to incentivize participants to save more is to offer employer matching or profit sharing contributions that are tied to their 401(k) deferral rates—the more they defer, the more the employer gives them.

There are always some participants who select their investments when they first enroll and never touch them again. Auto-rebalancing can be used to return the accounts to their intended asset allocation, often increasing returns and keeping risk in check.

¹ "2018 Driving Plan Health." Wells Fargo, 2018. Accessed January 2019.

² Pagliaro, Cynthia, and Stephen Utkus. "Choice Architecture and Participant Investment Decisions." *The Vanguard Group*, May 2018. Accessed January 2019. www.oecd.org/els/health-systems/Obesity-Update-2017.pdf.

³ Thaler, Richard, and Shlomo Benartzi. "Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving." *American Journal of Education*, Feb. 2004. Accessed January 2019. <https://www.journals.uchicago.edu/doi/abs/10.1086/380085?journalCode=ajp&>

Smart design leads to smart decisions

An article by Voya suggests using a Reflective Index to help apply choice architecture to the plan. It is possible to automate the determination of a participant's decision-making style. The Reflection Index evaluates participants on three decision-making style indicators: attention, information gathering, and making tradeoffs. The assessment gives insight into how participants in different plans are making decisions. Voya states, "By leveraging the insights of behavioral science and the data of the digital world, we can tailor our suggested 'course corrections'."⁴ Plan sponsors can use the index to help them make plan design decisions. For instance, plans where more participants are characterized by a *reflective* decision-making process should encourage their participants to re-evaluate their elections based on additional personalized information; whereas re-enrollment might be a better solution for plans if most participants are characterized by an *instinctive* decision-making process. "By making it easier for their participants to make the right decision, we can offer them another chance at a successful retirement."⁵

Something we may not think of as affecting a participant's retirement plan choices is the website design. Participants' interactions on websites can be tracked; then small changes can be made to lead participants to better choices. Simple changes to implement might include locating relevant plan information where the participant is being prompted to make a choice, making the language of enrollment options as simple as possible, or using a "traffic light" color design to guide choices.

One size doesn't fit all when it comes to participant communication. Tailor the plan's communications to have language and information designed for your workforce. This will help grab the participant's interest and improve the communication's overall effectiveness.

Saving to and through retirement

Choice architecture can be used not only to optimize auto features but also to help eliminate the loss of funds. Retirement Clearinghouse has recently developed a program which helps participants keep

track of their retirement funds as they move from job to job. For smaller account balances, which might otherwise get cashed out or rolled to an IRA by default, this program captures and tracks these assets by moving terminated participants' account balances with them to their new employer's plan—all by default.⁶

Another way savings can be preserved is by limiting opportunities to withdraw from the plan through loans, hardship withdrawals, in-service or termination cash outs.

Finally, choice architecture can even influence the age at which a participant might begin to draw down their savings. Using a "consider the future first" checklist of eight reasons to claim benefits later, The TIAA Institute encourages some participants to delay claiming their benefits for up to 18 months.⁷

In perspective

Whether a participant logs in once and makes a single choice or is making a lifetime of choices, there are many ways employers can use choice architecture to assist all types of decision-makers when they do engage. Understanding your employees and tailoring the approach can help them make the best decision—ultimately improving retirement readiness.

Questions? Contact the Findley consultant you normally work with or Laura Howald at Laura.Howald@findley.com or 615.665.5349.

© 2019 Findley. All Rights Reserved.

⁴ Benartzi, Shlomo. "Using Decision Styles to Improve Financial Outcomes." *Voya*. 2019. Accessed January 2019. www.voya.com/behavioralfinance.

⁵ Ibid.

⁶ "Moving Retirement Forward." *Retirement Clearinghouse*. January 2019. Accessed January 2019. <https://rch1.com/>.

⁷ Johnson, Eric, Kirstin Appelt, Melissa Knoll, and Jon Westfall. "Preference Checklists: Selective and Effective Choice Architecture for Retirement Decisions." *TIAA Institute*. June 2016. Accessed January 2019. https://www.tiaainstitute.org/sites/default/files/presentations/2017-02/ti_selective_effective_choice_architecture_for_retirement_decisions.pdf.