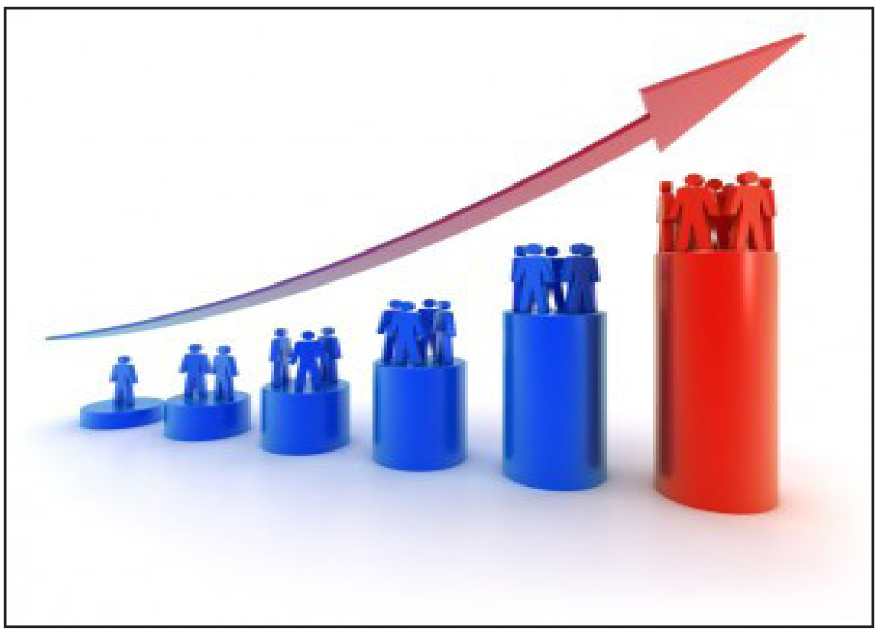
A Plan Sponsor Can Increase 401(k) Participation Without Costing Much $$$

By Ary Rosenbaum, Esq.

No matter the organization you're involved with, getting increased participation is always a big issue. Increased participation by current or new members is a goal whether it's a trade, religious, or fraternal organization. I was heavily involved in my former Synagogue and increased participation was always a big thing for me as I was in charge of membership related services. Getting more people involved is always a good thing. When it comes to participation in a 401(k) plan, plan sponsors have to a little more than having events that a trade or religious organization may host. Getting participants involved can be difficult, but it doesn't have to be costly. There are quite a few tools out there to increase plan participation that doesn't have to cost plan sponsors much money in terms of contributions and plan expenses.



Why increase plan participation?

Why should a plan sponsor be concerned about the participation of employees to defer into a 401(k) plan? Well, a plan sponsor should always remember why they implemented the 401(k) plan in the first place. They implemented the plan to provide a benefit to their employees, and for the benefit to be optimally utilized employees should be deferring part of their salary. Getting their employees to save for retirement is a good thing and a benefit like that that encourages people to save goes a long way in retaining these employees. A sign of a well-run 401(k) plan is a plan with a higher deferral rate for employees and a healthy average account balance. A plan that might not be considered in good shape is a 401(k) plan where few employees decide to actually defer because it raises possible compliance test problems and it may be an indication that the plan may have issues with their fiduciary process. Having the employees participate in their 401(k) plan is a good way of keeping up appearances that the plan is doing well. In addition, increased participation will mean increased assets. That's a big thing because the pricing of a 401(k) plan is highly dependent on assets as larger plans get better pricing than smaller plans. So increased assets through increased participation on the deferral side is a great way for the plan sponsor to get better pricing on their 401(k) plan. That's important because a plan sponsor has a fiduciary duty to pay reasonable plan expenses and a cut in expenses as a percentage of assets will help them with their fiduciary duty to pay reasonable plan expenses.

Add automatic enrollment

One of the greatest lines in the movie M*A*S*H is when Hotlips Houlihan (played by Sally Kellerman) wondered how a degenerated person like Hawkeye Pierce could have reached a position of responsibility in the Army Medical Corps. Father Mulcahy answered by saying that Hawkeye was drafted. So in light of that, one of the best ways to increase participation in a 401(k) plan is to "force" them through automatic enrollment. Automatic enrollment was originally called a "negative election" when it was first allowed in the late 1990s and it was finally codified in 2006. Since 2006, Automatic enrollment is a feature that many plan sponsors have adopted. It's a plan feature where they withhold a certain percentage of their employees' pay as a salary deferral into the 401(k) plan after the employee fails to affirmatively opt-out of the plan. Plans without an automatic enrollment feature only withhold money as a salary deferral when employees affirmatively elect to participate in the plan, so this a beneficial feature when participants forget to hand in a deferral election. If a plan sponsor automatically enrolls a plan participant and the participant doesn't want their money withheld, there is a mechanism to reverse those deferrals. People who don't like automatic enrollment state that employees will be upset when they discover that part of their salary is withheld for salary deferrals, but I believe that most employees won't pay attention when it's only 3-6% withheld. People tend to be passive, so they may not bother to go with the procedure of affirmatively declining a salary deferral election and try to retrieve their money. Most plans that use automatic enrollment set a 3% rate of deferral for those that are automatically enrolled and many accelerate that rate by 1% every year until they hit a maximum automatic deferral rate specified in the plan document. Before negative election became automatic enrollment in 2006, one of the knocks against it was that a plan sponsor was offered no fiduciary relief for losses incurred by participants in deferrals automatically deducted from their pay since the participant didn't direct their own investments in such a setting. Another benefit of the addition of automatic enrollment into the Internal Revenue Code is the fiduciary relief finally granted to plan sponsors. When it was negative election, plan sponsors would just invest those automatically enrolled deferrals into some type of money market or stable value investment. That's why I didn't like negative election because participants trapped in it had very little increase in their "forced" plan assets because there was little gain using money market or stable value funds. When it finally became automatic enrollment, fiduciary relief was granted to the plan sponsors as long as they invested those deferrals into a qualified default investment alternative (QDIA). So a plan sponsor using a QDIA for deferrals of participants that are automatically enrolled will not be liable for losses incurred by a participant as long as the plan sponsor manages the plan's fiduciary process in a prudent manner. I think a plan sponsor should always consider automatic enrollment whether their plan has a high deferral contribution rate or not. In addition to saving money for a participant's retirement, I believe a good job by the plan sponsor and their financial advisor to engage participants through interesting meetings and materials has the ability to make participants interested in actively participate by increasing their deferral rate and selecting their own investments. If the goal is to increase the deferral rate of plan participants, automatic enrollment is a "cheap" and "cheating" way to accomplish that.

Make enrollment meetings and materials interesting

One of my complaints about 401(k) enrollment meetings is that they are as exciting as a funeral. While I know a thing or two about 401(k) plans and investments, I've been at many meetings where the financial advisor can't even keep up my interest. So if a 401(k) plan expert is bored, what would they say for 401(k) plan participants who may have no knowledge of investments and retirement plans? I think a plan sponsor and a financial advisor should treat plan enrollment/investment education meetings as if they were a television show or a movie. That doesn't mean adding special effects, it means realizing that you actually have to keep a participant's interest at all times. Maybe add some comedy, make it fun to be there. Give out a $25 gift card as a raffle for those who attend. Speak to participants on their level; make them feel that they're missing something by not attending. Make the meeting interesting so that plan participants can understand and be interested in a topic most of them have no interest in. One of the biggest mistakes that an advisor makes is they treat these enrollment meetings as some sort of dissertation on investment theory, they don't understand that they need to speak to plan participants on a level that they can understand, they need to produce marketing materials that plan participants could actually read without needing a securities license. Heck, I've made a career as an ERISA attorney just by writing articles that are interesting, sometimes funny, and taking hard issues and breaking them down so that my readers can easily understand. Advisors should take a thing or two from my way of marketing to inject some life into these enrollment meetings.

Trim the investment options from the Plan

Plan sponsors and their advisors sometimes think it's a good idea to add so many different investment options to the 401(k) plan because they think a lot of choices is a good thing. To be honest, whoever said that too much choice is a good thing didn't sponsor a 401(k) plan. I'm sure that most plan sponsors and many financial advisors assume that dozens and dozens of investment options in a 401(k) plan are a good thing. Studies show that's not the case. As the number of different investment options grow in a 401(k) plan, deferral rates go down. Why? Well, plan participants feel overwhelmed with too many investment choices and they get paralyzed to the point of not participating. When a 401(k) plan has 3-5 large-cap mutual funds, participants with no investment knowledge won't understand the difference between funds. There are thousands and thousands of investment options out there. Trying to replicate that in a 401(k) plan investment lineup won't help a participant's rate of return. It will just overwhelm participants so that they won't even participate. I've seen 401(k) plan with 50-75 investment options and that's probably at least 30-55 too many. Pruning a retirement plan's fund lineup to a more manageable 12-20 funds will be a cost-effective way to increase participation in the 401(k) plan.

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