Unlocking the value of employee wellness from a health or financial perspective begins with rewarding good behaviors and eliminating the bad ones—those that lead to higher costs, lower productivity and lack of engagement.

When it comes to financial wellness and saving for retirement, value is based on reducing stress, confusion and uncertainty. It’s about providing peace of mind so employees can stay focused on their jobs and careers. It’s about career growth, workforce continuity and intentional retirements, with retirees having the health, wealth and time to enjoy their retirement years. Employers that sponsor a defined contribution (DC) plan have the opportunity and responsibility to help participants achieve a financially secure retirement. Here are three strategies employers can adopt to accomplish this.

Implement the “Autos”

Getting started can be the most difficult challenge to saving for retirement. Remaining at too low a savings rate
and adopting a misguided investment strategy can also be problematic. Studies show that DC plans with automatic features—automatic enrollment in qualified default investment alternatives (QDIAs) and automatic escalation—tend to produce better outcomes for participants than plans without them.

The effectiveness of auto features lies in behavioral economics. For example, hyperbolic discounting, which is the tendency for people to heavily discount the importance of future benefits (or consequences) in favor of immediate action (or inaction), is an obstacle many participants struggle to overcome. This behavior results in procrastination, even when there are tax incentives to save for retirement.

Loss aversion, where people are more motivated by avoiding a loss than by achieving a gain, is another example. This behavior can manifest itself in three ways when it comes to saving for retirement: (1) Employees decide not to join the DC plan because they don’t want to risk losing their money, (2) participants are reluctant to increase contributions when they receive pay raises since they don’t want to forgo or “lose” the net amount of the pay increase and (3) employees invest too much money in low-risk/low-return investments.

Automatic enrollment in QDIAs and automatic escalation can help surmount the impediments and consequences associated with these behavioral tendencies.

Institute the Four Ms—Milestones, Measurement, Monitoring and Management

Saving for retirement is more like a marathon than a sprint; it’s a journey, not an errand. Yet we like to judge success according to short-term indicators that may satisfy our immediate interests but do not help us achieve our long-term goals.

Giving participants daily or quarterly account balance information is fine, but what if we also gave them some milestones so they have a good idea of what they need to save every five years to reach a secure retirement?

Let’s presume the goal is to retire at the age of 65 with enough money to replace 80% of preretirement income. While the math, assumptions and variables can be somewhat intricate, we can turn to some guidelines developed by Charles Farrell (2010) in his book, Your Money Ratios. The table shows the estimated multiples of pay that need to be saved every five years starting at the age of 25 to reach the 80% goal by the age of 65.

Based on Farrell’s criteria and assumptions, which include Social Security, participants need to have saved 12 times their pay by the time they reach the age of 65 to generate enough income to replace 80% of their preretirement pay throughout retirement.

It then becomes far more useful to tell participants how much they need to save each year to reach these milestones and the ultimate goal. Farrell and others suggest this rate needs to be in the range of 12-15% of pay each year.

Participants often believe, however, they will achieve a secure retirement if they contribute enough to maximize the company match. This blind-faith acceptance can be attributed to another behavioral economics principle known as the endorsement effect.

What if we also gave participants an annual snapshot or measurement of how they are doing in relation to their retirement goals? What if we showed them, using a simple

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<thead>
<tr>
<th>Age</th>
<th>Savings as a Multiple of Pay</th>
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<tbody>
<tr>
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<td>65</td>
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graph, the savings path they are on and where that path leads to at retirement? And what if that graph showed them how close to or far from the path to a secure retirement they are? These measurements and this type of monitoring would give participants the ability to better understand and manage where they are going and what they need to do to change course or pick up the pace.

If they are falling behind, let’s use automatic escalation to help them manage their way back on track. Let’s offer target-date funds and managed accounts to help them decide their investment strategy and mix and to rebalance their investment portfolio when needed. Left to their own devices, participants are unlikely to act due to two other behavioral economic principles—choice overload, brought on by too many investment funds, and status quo bias, which is the predisposition not to disrupt the current state.

The data and technology exist to provide DC plan participants with the personalized information needed to stay on pace to a secure retirement. We need to begin to provide solutions to participants as part of standard DC plan features.

**Connect the Dots**

Over the years, DC plans have transformed from savings plans to primary retirement vehicles for many participants. As a result, it is increasingly important for them to think about account balances in terms of future income. A major challenge exists in getting participants to change their mindsets from wealth accumulation to retirement spend-down at a rate that matches life expectancy plus any bequests. To overcome this challenge, it’s important to start connecting the dots for participants.

Let’s start with the 4% rule, which basically states there is about a 90% chance that your savings will last 30 years if you withdraw 4% each year with an annual increase for inflation. The 4% rule has long been considered a safe withdrawal strategy, albeit an imperfect one, especially during periods of investment volatility. As a result, it is important to consider the 4% rule as more of a starting point or guideline rather than a strict rule. Nevertheless, it can be helpful in estimating how much savings a participant can withdraw each year and stay reasonably safe from running out of money.

Similarly, you can use the inverse of 4%, or 25, to estimate the amount of savings needed to generate a targeted level of income. For example, if you want to generate a retirement income of $50,000 per year in retirement and have a good chance it will last for 30 years, multiply it by 25 to arrive at the amount you need to save, which is $1,250,000. Or if you prefer to think of it the other way, if you save $1,250,000, divide it by 25 to arrive at the estimated annual income amount that will likely last for 30 years, which is $50,000.

So a rule of thumb to remember is that $25,000 of savings generates about $1,000 of annual retirement income. Or, every $1,000 of annual retirement income requires about
$25,000 in savings. Keep in mind these are general guidelines and not hard-and-fast rules. They also do not include Social Security or other retirement benefits participants may receive.

These guidelines and rules of thumb only begin to connect the dots. There are many other issues and risks that should be addressed. For example, longevity risk is the risk that a person will outlive the money saved for retirement. This risk used to be borne by companies that provided defined benefit plans to their employees. As these plans have been replaced by DC plans, longevity risk and investment risk have shifted to participants. And just to make the situation more precarious, retirees also have to cope with cognitive risk—the risk they will lose the mental capacity to make sound financial decisions as they get older.

There are a number of options to address these risks. These options range from various types of annuity products to managed payout programs offered within DC plans or through investment fund providers. Recently, the U.S. Department of the Treasury, Internal Revenue Service and U.S. Department of Labor have provided support and guidance to permit target-date funds to include deferred income annuities and satisfy QDIA requirements. As a result, we should expect to see more DC plan distribution solutions that connect the dots between account balances and retirement income.

**Conclusion**

While plan participants may need more financial education, education alone does not guarantee success. Left on their own, participants tend to behave in ways that make it harder to achieve a secure retirement. It’s not their fault; it’s predictable human behavior.

The know-how, data and technology exist to achieve better outcomes. The time has come to adopt and implement the features and solutions that we know work. By doing so, we will help DC plan participants achieve improved financial wellness and enjoy greater financial security in their retirement years.

**Reference**