

**EFFECTIVENESS OF EMPLOYER-PROVIDED FINANCIAL INFORMATION:
HIRING TO RETIRING**

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ABSTRACT

Workers plan and save for retirement throughout their careers. Individuals must navigate complex financial instruments and understand public and employer-provided retirement plan characteristics. Beginning when a worker is first hired, most employers provide the option to contribute to retirement saving plans. As workers near retirement, they face many choices that have considerable consequences for their retirement income security. At these two important periods, employers can provide timely information assisting workers in making choices that optimize lifetime wellbeing. Our research, conducted in cooperation with several large employers, illustrates the importance of employer-provided education in increasing worker understanding of several retirement-related issues.

Effectiveness of Employer-Provided Financial Information: Hiring to Retiring¹

In order to maximize lifetime utility, workers must make choices throughout their careers to plan and save for retirement. With the aging of the Baby Boomers and increasing life expectancies, it is more important than ever for individuals to ensure they have adequate savings and resources for retirement. To make optimal choices, individuals need sufficient knowledge of how both national and employer-provided retirement plans work and what benefits they should expect. Further, they must have adequate financial literacy to navigate complex financial instruments and to understand the importance of various plan characteristics.

Traditional economic models of lifecycle earnings and consumption are based on the assumption that workers are aware of investment options, understand the benefits they will receive from various retirement plans, and have the ability to assess the impact of their saving decisions on both the accumulation and deaccumulation of retirement wealth. Evidence described below indicates that workers have a low level of financial literacy and a poor estimation of the value of and key parameters of Social Security and pension plans. This is particularly true for workers at the beginnings of their careers who often do not take advantage of generous employer matching contributions to voluntary retirement savings plans. At the other end of careers, workers approaching retirement must make a series of important choices, many of which are irreversible. Workers must choose when to retire, when to claim benefits, and whether and how much of their wealth to annuitize. Without accurate information and financial

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knowledge, workers may make suboptimal employment and investment decisions. Improved financial literacy should enable workers to make better retirement saving choices. Where can workers best acquire the knowledge and financial literacy needed to make optimal retirement decisions? Evidence described here indicates that the workplace provides an excellent location for financial literacy programs.

I. Background on Financial Literacy and Employer-Provided Financial Education

Employers provide retirement plans to help achieve human resource (HR) objectives including hiring, retaining, motivating, and ultimately, retiring quality workers. Economic incentives are often imbedded in retirement plans to alter worker behavior. If workers are unaware of the value of their retirement programs, they will not properly value total compensation and will not respond to the incentives that are built into pension plans. Thus, the business case for workplace financial education is that enhanced understanding of financial mathematics, retirement programs, and the incentives in these programs will alter worker behavior and allow firms to achieve their strategic objectives.

Evidence suggests that older workers do not have sufficient financial literacy to make optimal choices as they transition from work to retirement (Bernheim, 1995; Lusardi and Mitchell, 2007). Mitchell (1988) provides the first detailed assessment of worker knowledge of the basic characteristics of their pension plans. She reports that many workers do not know the type of pension that they have nor do they understand contribution provisions and the labor supply incentives imbedded in the plan. Gustman and Steinmeier (2004) compared the self-reported pension data to that provided by employers in the Health and Retirement Study and conclude that respondent reports differed substantially from the information contained in the employer linked data.

Pre-retirement planning seminars can efficiently address numerous concerns of individuals approaching retirement, thereby reducing human resources costs. Many employers currently offer retirement planning seminars for their workers (Sabelhaus, Brogdan, and Holden, 2008; Wray, 2008). Employers are currently investing considerable resources to provide workers with information about their retirement programs, along with tools needed to assess the value of these programs. This paper highlights findings from a series of projects where we have worked with large national employers to evaluate the effectiveness of educational efforts.

II. Workplace Education for Newly Hired Employees

When individuals enter the labor force, they must immediately make important choices about their lifetime consumption and saving profiles. Most newly hired employees complete a company orientation program that includes a discussion of voluntary retirement savings programs. In a project funded by the SSA through the Financial Literacy Center, we examined the retirement saving decisions of new hires.² We partnered with six large employers; all offered a retirement savings plan. Except one, the employers provide matching contributions up to a certain percentage of salary. All the employers except one had a defined benefit pension plan in addition to the 401(k) plan. Each employer provided administrative records for every employee hired between 2008 and 2010. In addition, a survey was set to all persons hired by the firms between December 2010 and May 2011. Along with questions on worker financial literacy, respondents were asked their contribution status. For workers that were currently contributing, the survey asked what factors influenced their decision to participate in the 401(k) plan and the amount that they contributed. For workers not currently participating in the plan, questions aimed at understanding the reasons for non-participation were included.

² This research is described in more detail in Clark and Morrill (2010) and Clark, Morrill, and Maki (2011a,b).

Using the administrative records and survey data, we examined participation and contribution rates of newly hired workers. Some plans require that employees be on the job for a specified period of time before they are eligible to participate in the plan. Similarly, plans often require a specified level of tenure before workers are eligible for an employer match. Since these two waiting periods are often months after employment and orientation, they provide important teachable moments for employers to nudge their new employees to contribute to the 401(k) plan. Employees respond to the employer match by significant bunching at the maximum matching contribution rate and by increases in participation when they become eligible for the employer match. Survey results indicate that match terms and eligibility are important determinants of participation and contribution rate choices.

Automatic enrollment and automatic escalation also influence participation and contribution rates. Plans with automatic enrollment place new employees in the plan at a specified contribution rate. Workers are allowed to opt out of the plan but the onus is on the employee to complete the necessary forms to withdraw from the plan. Since the passage of the Pension Protection Act in 2006, more employers have adopted automatic enrollment policies and a few have established automatic escalation features into their plans. Two of our employer-partners have 401(k) plans with automatic enrollment. Among the firms in our studies, enrollment rates average 60 to 80 percent for firms without automatic enrollment compared to over 90 percent for the firms with automatic enrollment. Further, at one employer, using data from before and after the automatic enrollment policy was implemented we find the policy significantly increased participation rates.

Most plans with automatic enrollment adopt a default contribution rate that is substantially less than the maximum contribution that is matched by the employer. Our analysis

shows that a majority of new employees are contributing the default contribution amount. If workers remain at the default level, they forgo significant employer contributions. At employers without automatic enrollment, many workers chose not to participate in the 401(k) plan because of a limited budget and the desire to pay off debts. Thus, employers that implement automatic enrollment policies should facilitate workers making optimal retirement saving choices by providing clear and timely information concerning the money that is being automatically deducted from their monthly pay.

Most respondents thought their employer had provided them with “very comprehensive” information. However, a quarter thought they would have benefited from additional information. Almost all new employees reported that the information provided by their employer influenced their decision to participate in the 401(k) plan. A series of financial literacy questions indicated that individuals who were already contributing to the plan had significantly higher financial literacy compared to those workers who had not yet enrolled in the plan. The evidence is consistent with the hypothesis that those with greater knowledge about their retirement plans and a higher level of financial literacy will be more likely to enroll in retirement saving plans.

When an employer provides information about the plan to non-participants, it may serve not only to educate workers but might also “nudge” them to participate (Thaler and Sunstein, 2008). Can periodic nudges by one’s employer, even several years after initial employment, lead to increased enrollment rates in retirement savings plans? To explore this, we implemented a controlled experiment with one of our employer-partners.³ We developed a flyer describing the retirement wealth that can be created with small contributions over a long career. All employees hired between 2008 and 2010 who were not currently participating in the 401(k) plan were randomly assigned to the treatment or control group.

³ Results from this experiment are described more fully in Clark, Morrill, and Maki (2011a,b).

A few months after the flyers were sent the employer provided us with an update of workers' participation status. Some employees in both the control and treatment group chose to enroll in the plan over the study period. Among those in the treatment group, 6.8 percent of those that were not contributing prior to receiving the flyer began contributing to the plan while only 5.9 percent of those in the control group began contributing; however, the difference is not statistically significant. Significant differences in participation were observed for the youngest workers (aged 18-24) with a 7.7 percent jump in participation among those receiving the flyer compared to only a 3.3 percent increase for similar aged workers in the control group. The findings from this randomized experiment provide additional support that employer provided financial information can influence worker behavior.

III. Workplace Education for Employees Nearing Retirement

Retirement eligible employees are on the verge of making decisions that will affect their economic well-being in retirement. Some of these choices are irreversible and errors can dramatically alter income in retirement. Surveys of older workers find that many do not have sufficient understanding of basic financial and investment issues needed to make the optimal decisions during the transition from work to retirement (Lusardi and Mitchell, 2007). Many large employers provide their older workers with the opportunity to participate in retirement planning and financial education programs. In general, these programs do not require registration fees and are conducted during the workday. While all programs are voluntary, employers report that over time most workers eligible to participate attend one of the events, thus minimizing the possibility of selection bias in the sample of participants. In a project funded by the FINRA Investor Education Foundation, we partnered with nine large national employers to assess the

impacts of retirement planning seminars.⁴ At five employers from June 2008 through December 2009, employees were surveyed prior to attending a pre-retirement seminar, immediately after the conclusion of the program, and again one year later. The surveys ask detailed information on household wealth, retirement plans, and financial literacy.⁵ Participants were also asked to evaluate the planning programs.

The surveys included a series of questions that allow us to examine the relationship between financial literacy and retirement plans in more depth. Using a bank of questions to develop a knowledge index, coupled with questions on self-assessment, enables us to go beyond the scope of other surveys to determine what respondents knew about their company retirement plans, Social Security, and Medicare. In the survey immediately following the seminar, workers were asked to rate the quality of the seminars and the value of the information provided to them. Respondents gave the events high marks and indicated that the information would affect their retirement plans. Many respondents also reported that they would like to have had to opportunity to participate in programs like the seminar earlier in their careers because the information would have helped them better prepare for retirement.

The retirement planning programs offered by the companies we studied ranged from half-day programs to two and half day events. All of the programs included sessions on company defined benefit plans, supplemental retirement savings plans, health insurance, Social Security, and Medicare, along with discussions on various financial decisions facing retirees. The surveys included 12 financial literacy and retirement knowledge questions. Participant scores on these knowledge questions increased significantly after the seminar. In particular, respondents were more likely to know ages of eligibility of their employer pension, Social Security, and Medicare,

⁴ Findings from this project are described more fully in Clark, Morrill, and Allen (2010, 2011a, 2011b).

⁵ The financial literacy questions included were based on previous studies (see, e.g., Lusardi and Mitchell, 2007).

and their responses to the financial literacy questions on inflation and investment diversity also were more accurate. Participants were re-interviewed one year later and their knowledge scores remained significantly higher than their pre-seminar scores. Results indicate that older workers increase the level of their financial literacy and enhance their understanding of Social Security, Medicare, and company retirement policies by participating in a pre-retirement planning event.

Prior to participating in the retirement seminars, individuals were asked to indicate their planned retirement age, the age that they anticipate initial claiming of Social Security benefits, whether they planned to work after retirement, whether they planned to take a lump sum distribution from their defined benefit pension plan, and whether they planned to annuitize some or all of their account balance in 401(k) plans. Retirement plans of older workers will be influenced by standard economic and demographic variables such as financial wealth, pension and Social Security wealth, health insurance, anticipated health care costs, housing wealth, earnings, life expectancy, marital status, and the pension and health insurance coverage of a spouse. Individuals' retirement plans are also determined by their knowledge of employer and national retirement benefits, their ability to understand the economic incentives imbedded in these plans, and their level of financial literacy that enables them to understand how their wealth and purchasing power will change during their retirement years.

The impact of incorrect information concerning retirement plans depends on the nature of the error. Misinformed employees who think that Social Security or company pension benefits can be obtained at later ages than the actual age of eligibility have higher planned retirement ages than correctly informed employees. Workers who mistakenly believe that normal Social Security benefits can be accessed at earlier ages than allowed say they expect to retire earlier than otherwise equivalent employees with accurate information. In contrast, beliefs that one can

access Social Security or company pension benefits prior to the actual minimum age of eligibility appear to be unassociated with planned retirement age. (Clark, Morrill, Allen, 2011 forthcoming). After completing the retirement planning seminars, participants were asked the same questions concerning their retirement plans and the utilization of their retirement wealth. We document the knowledge that participants gained during the retirement seminars and estimate the changes that were made in participants' retirement plans based on their enhanced financial literacy. Preliminary results indicate that gains in knowledge do alter retirement plans for many participants. When older workers have a better understanding of their retirement plans and financial issues, they reevaluate their retirement plans in accordance with the new knowledge. This finding is consistent with standard lifecycle theory which predicts that workers re-optimize their time allocation and consumption/saving decisions when state variables change.

IV. Conclusions on the Importance of Employer Provided Financial Education

Financial literacy and knowledge of retirement programs are important determinants of retirement plans and retirement income security. Two periods of employment stand out as essential times for making and executing retirement saving and labor market decisions. When first employed, workers often have important choices to make concerning enrollment in and contributions to retirement saving plans. Financial concepts such as compounding of returns over one's working career and risk and return characteristics are important for workers to understand. Providing timely information of the benefits of participation, along with a clear explanation of the eligibility requirements and employer matching contributions, can encourage workers to take full advantage of these retirement savings plans. Our research, conducted in cooperation with several large employers, illustrates the importance of employer-provided education in increasing worker knowledge and understanding of these issues.

As workers approach retirement, they must make a series of economic decisions that will affect their well-being in retirement. In order to maximize their lifetime utility, employees need to understand the characteristics of retirement plans and must possess the financial knowledge to assess the impact of their choices. Our research examining the retirement planning and financial literacy programs of several large employers indicates that workers do learn in these seminars, and on the basis of enhanced financial literacy, many workers alter their retirement plans.

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