

# A Christmas Gift for Your Employees

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**“Give a man a fish and you feed him for a day; teach him how to fish and you feed him for a lifetime.” - Lao Tzu**

Although the fish parable often used by Dr. Steven Covey may be true for most aspects of life, it may not apply to defined contribution plans. David Laibson and colleagues report that employer groups like physicians that provide investment education to their employees to enhance optimal 401(k) investment choices, don't have much success. This leaves the question, what should employers do for their employees if they have their best interests at heart and want to help them save for retirement?

The paper that addresses these issues by James Choi, David Laibson, Brigitte C. Madrian and Andrew Metrick was published in American Economic Review Papers and Proceedings, May 2003, pp. 180-185. It is entitled Optimal Defaults. This paper is worth reviewing because the analysis it contains is crucial to the ultimate welfare of employees. What better time to think of this than Christmas?

As it turns out, programming a 401(k) to the employees' benefit yields employees more long-term return than cursory investment education. This knowledge is important to employers who can direct their company's 401(k) plans to include features which help the employee and are cost free to the employer.

The researchers studied both individuals enrolled in a 401(k) and those not yet enrolled. They were examined during and after an educational seminar designed to teach them about investing. The objective was to determine if the participants that attended the seminar followed up on the actions that they planned based on what they learned in the class. These of some of their findings:

100% of the attendees that were not already in a 401(k) said they would enroll during the seminar. Only 14% did.

Interestingly 7% of those that did not go to the seminar also enrolled. Though it could be said that the education doubled enrollment, this interpretation is excessively optimistic when only 14/100 who said they would enroll actually did so.

Among those already enrolled in 401(k) plans, the investigators looked at three measures of benefit to the employee related to the education:

1. An increased contribution rate to take advantage of their employer's matched

- contribution and the tax deferral. At the seminar 28% said they would increase their contribution. Only 8% did.
2. A change of fund selection to improve performance and perhaps lower costs. At the seminar, 47% said they were going to make a change. Only 15% did.
  3. A change of asset allocation to improve long term performance with less risk by achieving a balance between US stocks, bonds and international funds. At the seminar 36% said they would make changes. Only 10% did.

These figures mean that intentions were substantially greater than action. In fact, employees who did not attend the seminar made changes in similar, though lesser proportions, without benefit of the seminar. Five percent of this non-attending group increased their contribution. Ten percent made a fund selection change and six percent altered allocation.

The researchers concluded that brief financial education, which is the maximum instruction that virtually all employer groups offer, has only a small effect on the actual investment choices of employees. Though the seminar attendees had good intentions for executing 401(k) actions that would benefit them, they did not follow through. Ultimately, this lack of action can make a big difference in retirement income and significantly negatively impact available resources in old age.

Employers can turn this around at no cost to themselves simply by designing a plan that automatically enrolls employees in their 401(k) defined contribution plans. Further, they can make it easy for employees to add to their savings as their income increases by making the contribution a percentage of salary. Additionally, by offering good options that historically provide the most gain with the least risk, employers can further help employees. For example, those employees that don't want to make a decision about investment options can be automatically enrolled in a life cycle fund that becomes more conservative with age. All of this is discussed in my next blog.

Employees can opt out of the above options, but if they suffer from inertia, like so many of us do, they will automatically be invested in appropriate low cost vehicles that will glean them the most return for the least risk that their salary contribution will allow.

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