

► **Financial Planning**

Financial Planning for Employees Post- Enron

by William J. Arnone

► “Enron” has become shorthand for a broad range of potential risks associated with defined contribution plans. The Enron situation may propel plan sponsors to examine their retirement plans from a risk management perspective and start taking employee financial planning more seriously. *This article discusses an optimal program based on best practices for accomplishing this critical objective.* ◀

Enron. In mass media and benefits trade publications during the past year, this word was invariably followed by words like “tragedy,” “debacle,” “disaster,” “catastrophe,” “fiasco,” “train wreck” or “meltdown.” At the National Summit on Retirement Savings convened by the U.S. Secretary of Labor in Washington in February 2002, one member of Congress even referred to the “Enron hoo-ha.”

In connection with the loss of substantial 401(k) account funds by Enron employees, the word “Enron” has become shorthand for a broad range of potential risks associated with defined contribution plans. One is the risk of investment losses due to the lack of diversification in general and due to overconcentration of retirement assets in employer stock in particular. Another is the risk of losses due to the inability of participants to act during plan “lock-out” periods. There is also the risk of losses due to insufficient information disclosed to participants in an understandable and actionable manner. As a result, participants have made their situation actionable in a very different sense by seeking recourse to the courts through litigation against plan sponsors, thereby posing the risk of liability to employers.

Enron-related publicity—coming on the heels of a major slump in the performance of stocks since March 2001, which was the first real bear market experience for most defined contribution plan participants, and coupled with recent studies questioning the effectiveness of defined contribution plans in helping to provide adequate future retirement income for most of today’s workers—has created heightened sensitivity for plan fiduciaries over the retirement security prospects of their employees. Proponents of employer activities to help participants make wise, long-range plans for retirement may find that senior management has become more receptive to proposals for an enhanced, ongoing program of personal financial education and counseling.

Just as Studebaker became a rallying cry for defined benefit pension reform leading to the enactment of the Employee Retirement Income Security Act (ERISA) in 1974, many believe that Enron will become a watershed event leading to defined contribution pension reform.

A key element of any reform will be clarification of a plan sponsor's responsibility to provide all employees with financial planning tools and services.

What issues should plan sponsors consider in providing employer-sponsored financial planning activities for employees?

The fundamental question to ask is whether an organization is diligently assessing its obligations and, where appropriate, adopting best practices in connection with employee financial planning.

For the past 25 years, I have been deeply involved in retirement income policy and retirement planning practices in the United States. I vividly recall senior corporate executives in the late '70s and early '80s reacting to the notion of employer-sponsored retirement planning programs with a simple "why?" The prevailing view then was that planning for retirement was a personal matter for each employee. More often than not, even human resource (HR) vice presidents characterized this as "none of our business."

Due largely to the enormous shift in retirement funding from defined benefit to defined contribution plans that took root in the '80s, as well as the spread of employee mobility and the need for employee adaptability, large leading employers began to rethink their position. They recognized that, for this shift to succeed, employees had to be more involved and better equipped to manage their financial futures. Gradually, "why?" evolved to "how?" Employee success in achieving financial security became part of the business of the human resource function, especially as its strategic focus turned to recruiting, retaining and motivating a committed, productive workforce and optimizing the management of human capital to increase profitability and enhance shareholder value. Growing employer interest in promoting work/life balance and total employee wellness has provided a sound framework in which to position employee financial planning. How then can employers develop and deliver cost-effective financial planning programs that make sense in view of their business needs, human resource goals, unique cultures and enterprisewide values?

Despite this progress, however, a minority of employers today offer broad financial planning

to all employees as an ongoing component of their total rewards package. Employer surveys vary in their findings, depending on how they define a financial planning program. At best, no more than 40% of large employers (i.e., more than 1,000 employees) offer what they believe is some type of program. Using an optimal definition—an employer-paid program available throughout the year during working hours and including both education that is custom tailored to the employer's specific benefit plans and counseling that is individualized to each employee—I estimate that fewer than half of these employers, or 20% of the total, can legitimately claim that they have such a program. The vast majority of the 42 million participants in 401(k) plans, representing nearly two out of five U.S. households, are in effect on their own when it comes to obtaining financial planning assistance. This is so even though such plans have become the primary retirement vehicles for most and even though plan balances represent, for most, their largest asset, other than perhaps the equity in their homes.

A RISK MANAGEMENT PERSPECTIVE

What may well be the factor that propels employers to take employee financial planning more seriously is the post-Enron need to examine retirement plans from a risk management perspective. Once an employer concludes that an optimal program based on best practices makes sense, especially from this perspective, what issues should it then consider? The issues may be categorized as follows:

- Conducting initial baseline research
- Establishing goals
- Defining scope of content
- Identifying deliverables
- Assessing costs
- Selecting providers
- Developing an implementation timeline
- Monitoring program execution
- Evaluating outcomes
- Modifying deliverables
- Adjusting costs.

Initial Baseline Research

A successful program needs a baseline of data from which to measure progress. In view of technological advances in plan recordkeep-

ing, more data on employee 401(k) and other benefit plan activities are now available to identify patterns that may have serious long-term retirement security consequences. Patterns of potential problems include:

- Nonparticipation in plans
- Low plan contribution rates, including failure to at least gain the full employer match on the one hand and limiting contributions only to matched dollars on the other
- Loans from plans
- Questionable asset allocation
- Failure to rebalance funds periodically
- Nondiversification of retirement assets
- Cashouts instead of deferrals or direct rollovers upon termination
- Forfeitures of flexible spending account balances
- Low levels of supplemental life and disability insurance
- Absence of, or outdated, beneficiary designations
- Premature exercise of stock options
- Gaps in health coverage.

Such data will be more meaningful if supplemented with qualitative assessments of different employee population segments. Sources of segmentation data are surveys, individual interviews and focus groups. Employees may be segmented in many different ways, including demographic cuts (e.g., age, years of service, gender, income, education), job (e.g., business unit, location, function, pay level), financial sophistication (e.g., basic financial literacy, interest in money management, investment savvy, retirement confidence) and learning styles (e.g., self-study vs. instructor led, group learning vs. individual counseling, live vs. Web based, text vs. graphics).

Employer interest in some type of qualitative workforce segmentation appears to be growing. The *Retirement Confidence* survey, conducted by Matthew Greenwald and Associates on behalf of the Employee Benefit Research Institute (EBRI), provides one framework with nationwide data that an employer can use for benchmarking purposes. The 2002 survey found that the U.S. population breaks down into the following personality types (percentages do not total 100 due to rounding):

- Deniers (dislike any planning, retirement is out of reach): 15%

- Impulsives (not disciplined, prone to setbacks): 24%
- Strugglers (easily deterred by unexpected events): 18%
- Savers (careful and disciplined, but risk averse): 19%
- Planners (disciplined risk takers, enjoy financial matters): 23%

Knowing the breakdown of the employee population can help an employer determine what to emphasize in its program, with one objective being to move more of its population into the “Planners” and “Savers” categories.

Goals

Program goals will vary depending on initial research findings. Among the most common goals are:

- Translate benefit plan features into value to employees as customers
- Facilitate benefit plan changes, such as moves from traditional final average pay defined benefit to cash balance or defined contribution plans, that require employee understanding and behavioral change
- Help employees take more personal responsibility for making critical decisions both within and among benefit plans and programs
- Generate greater employee appreciation for employer investment in the total rewards package
- Enable employees to leave when they desire or when business factors necessitate, with or without voluntary termination incentives, such as early retirement subsidies or windows
- Promote more of a self-reliant and flexible mindset among employees.

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Employers are increasingly concerned about protecting employees' long-range security, not only from a potential lack of diversification or other investment problems, but also from mistakes that jeopardize their overall financial well-being—such as inadequate insurance, out-of-control spending and debt, poor preparation for dependents' needs and the lack of a current will or estate plan. This broadened concern has been one result of September 11, 2001. Affected employers in New York who have been counseling survivors have noted the widespread extent of basic financial planning mistakes or oversights on the part of their deceased employees.

Scope of Content

Depending again on research findings, program content may have to be tailored initially to address the most serious patterns of potential problems and perceived employee needs. For example, if there is a substantial bubble of older employees in the workforce, which is highly likely as the massive boomer generation reaches retirement age, then the initial focus may be on preretirement issues. Even if preretirement is the focus, however, another key content decision is whether to focus on retirement finances only, or to include such retirement concerns as physical and mental health, housing, life adjustments, meaningful postretirement activities and legacy planning.

If the program's reach will encompass the entire employee population, then retirement cannot be the exclusive focus. Younger employees often need to address nonretirement issues—spending and debt management, buying a home, funding children's education, caring for elderly parents—before they can even begin to pay attention to their own future financial independence.

A serious scope of content issue is whether the program should include specific investment advice. From a risk management perspective, the risk of offering advice needs to be assessed against the risk of not offering advice at all. Currently, approximately 10% of large plan sponsors offer such advice to their employees. Surveys indicate that the most important factor in a plan sponsor's decision not to offer advice is concern over liability exposure if the advice proves ineffective.

Under ERISA, retirement plan providers, such as 401(k) investment managers, are prohib-

ited from giving plan participants advice on transactions that may benefit the providers. Different approaches to surmount this barrier to employer-sponsored investment advice for employees are being discussed in Washington, D.C. While prospects for enactment of legislation on this topic seem unlikely in 2002, differences in approach give plan sponsors indications of the directions federal lawmakers and regulators might take.

Investment advice approaches fall into one of three categories.

Advice Directly From Plan Providers With Disclosures

The Retirement Security Advice Act, sponsored by Rep. John Boehner (R-Ohio), passed the House of Representatives in November 2001. It has the support of the Bush administration, and its investment advice provisions have been endorsed by the U.S. Department of Labor. Under this bill, a plan sponsor may authorize a plan provider to take on the role of investment advisor under ERISA. The advisor may be a provider or manager of plan investment funds, but must disclose to participants relevant fees and potential conflicts of interest. The provider would be able to give advice directly to participants without using independent sources of advice. This bill has been referred to the Senate.

Advice From Plan Providers Using Independent Sources

The Labor Department issued advisory opinion 2001-09A in December 2001 to SunAmerica, allowing a financial institution to offer advice to plan participants, but only if the source of the advice is independent of the institution as plan provider. This opinion also allows participants to delegate investment decisions to independent advisors who in effect take over the management of their accounts. The opinion defined *independent* as receiving no more than 5% of revenues from a source related to the financial institution.

Advice From Independent Sources Only

The Independent Investment Advice Act, introduced by Sen. Jeff Bingaman (D-New Mex.), would protect plan sponsors who offer investment advice from liability, but only if the advice

is given by independent firms that do not provide or manage plan funds. The Protecting America's Pensions Act, sponsored by Sen. Edward Kennedy (D-Mass.), and The Worker Investment and Retirement Education Act, sponsored by Sen. John Kerry (D-Mass.), reflect the Bingaman advice approach. The Senate Committee on Health, Education, Labor and Pension approved Sen. Kennedy's bill in March.

Until further action by Congress or the Labor Department, many plan sponsors may have concerns about the extent to which they could be liable for losses with respect to investment advice that they make available to participants. Labor Department regulations issued in 1992 under ERISA Section 404(c) and Interpretive Bulletin 96-01 on investment education have not, according to some, given enough guidance.

Deliverables

Effective programs require a holistic blend of high-tech and high-touch deliverables that are not only customized to the employer's benefits but also personalized to each employee's needs and wants. The figure on page 40 illustrates the range of deliverables along a personalization spectrum.

Employers need to consider a more proactive program of targeted interventions to minimize the likelihood of serious employee mistakes. For example, employees who are leaving money on the table by failing to contribute enough to their 401(k) plan to gain the full employer matching contribution would receive a personalized alert. This communication would simply point this out and remind recipients that they have access to financial planning tools and services that can help them explore ways to save more. From a risk management perspective, this type of intervention has a higher likelihood of moving participants to take action. If its receipt is documented and includes some form of action or acknowledgment by the recipient, this can further help insulate the plan sponsor later on.

Employers might also give serious consideration to programs that build on behavioral finance research by defaulting employees into desirable modes of behavior, instead of expecting employees to opt into such modes deliberately and rationally.

Cost Assessment

Program costs, which should properly be viewed as an investment in human capital, will be highly correlated with the amount of research, program reach, scope of content and the range of deliverables. Typical ranges are from \$50 to \$300 per employee per year. Program champions need to position such costs in relation to other human resource, compensation and benefit expenditures, as well as in relation to the potential costs of litigation.

Employers need to strike the right balance between program elements that are financed by the employer for all employees and those that are funded only by employees who are interested. For those program elements that are employee paid, a further decision is the method of payment. Employee-paid options include incorporating financial planning packages in a flexible benefits program paid through payroll deduction; enabling employees to sign up for a payroll deduction program "just in time" instead of only during annual open enrollment periods; and charging employees' individual account assets for the costs of the program. Despite surveys indicating that employees say they will pay for worksite financial planning programs, most voluntary programs experience annual enrollments of less than 10% of the eligible population. Employees who do not enroll are typically those who need help the most—namely, lower-paid workers whose plan assets often account for most, if not all, of their lifetime savings.

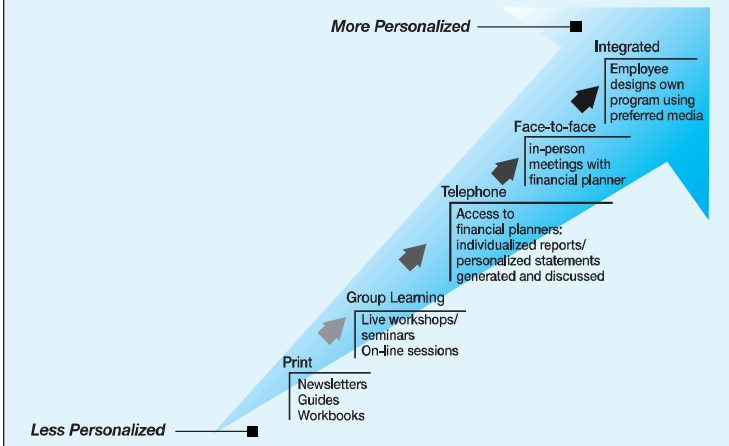
Employer-paid programs that focus on an organization's retirement plan do not generate taxable income to employees, due to enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001. Some have proposed further federal tax incentives, including enabling employees to pay for financial planning with pretax dollars and providing tax credits to employers to help offset the cost of employer-paid programs. The likelihood of further tax incentives in this area is slim in view of the reemergence of federal deficits.

Selection of Providers

The threshold question for employers will be the type of provider. Financial planning providers can be categorized as follows:

FIGURE

Financial Planning Program Spectrum



- **Fee only:** These are providers that neither sell directly nor benefit financially indirectly from investment products, such as mutual funds or insurance policies. Accounting firms and independent benefit consulting firms, as well as some regional or boutique financial planning firms, comprise this category.
- **Fee based:** These are providers that do have economic interests in financial product sales, but create a “wall” between such sales and the unit that provides financial planning. Most financial planning firms, whether national, regional or local, are in this category. Some investment firms and insurance companies take this approach, compensating their financial planners on a salary basis without incentives for product sales.
- **Commission based:** These are providers that sell financial products and use sales representatives to deliver financial planning services. Most mutual fund companies, investment firms and insurance companies are in this category.

Documented due diligence is the hallmark of a sound selection process. The selection process may be broken down into a request for information (RFI) phase and a request for proposal (RFP) phase. In the RFI phase, the employer, often with the assistance of an independent consultant, examines the financial planning marketplace to identify best practices, including tools and services that other peer em-

ployers have deployed to help their employees, and the leading providers being used. In the RFP phase, the employer narrows the field of potential providers by asking very specific questions on all aspects of its desired program. Finalists are then typically invited to conduct presentations followed by site visits to enable the employer’s selection team to “kick the tires” of all of the provider’s deliverables. Such site visits are essential to differentiate sales and marketing pitches from actual capabilities.

Implementation Timeline

There is a direct correlation between the amount of time and effort in the research phase of a program and the smoothness of its launch. Too many shortcuts, while tempting, are likely to cause a program to bleed later on. A successful implementation requires significant preparation and ramp-up. The necessary lead time will be increased to the extent that deliverables are localized (e.g., on-site workshops) and technology (i.e., Web-based offerings) is involved. At the risk of alienating those involved in the technology business, I have found a general rule to be quite helpful in dealing with the technological components of a program. I call it the 2×2×2½ rule. When you describe the high-tech elements of a program to your technology provider and you obtain an estimate of the timetable and the cost, double the time, double the cost and expect to get half of what you expected.

Logistics are critical, especially where there are many business units whose buy-in and support are necessary. Early identification and involvement of local champions, typically HR or benefits representatives, is essential. In addition, engaging and deploying employee opinion leaders can make a real difference in the early word of mouth that can cause a program to get off to a great start.

The likelihood of success is increased significantly when there is at least six months and as much as one year between the decision to develop a program and its launch.

Monitoring

Despite the most rigorous program design and implementation processes, surprises during the execution phase are inevitable. Especially in the early stages of program implementation, a

team of employer and provider representatives needs to be in daily contact to highlight unforeseen developments and fashion uniform responses. For example, workshop leaders need to note and transmit unanticipated questions, observations and misunderstandings on the part of participants about benefit plans to all who interact with employees. Consistent answers then need to be provided to employees in each mode of interaction, from workshops to phone counseling to online posting of frequently asked questions.

More importantly, monitoring results is crucial. Early detection of patterns of problematic employee behavior will enable program providers to sharpen their key messages.

Evaluation of Outcomes

Employers need to evaluate the effectiveness of their programs in actually changing employee knowledge, attitudes and behavior for the better. This involves the careful setting of short-term, intermediate and long-term metrics to measure program success and to ensure accountability.

Short-term metrics typically focus on immediate employee reaction to program content. Pre- and postworkshop evaluations capture the extent to which participants believe that the group learning experience has been helpful. Most group learning evaluations, however, capture nothing more than “feel-good” reactions. More attention needs to be given to actual advances in employee knowledge through pre- and postworkshop testing on questions of substance.

Intermediate-term metrics look at employee knowledge and action during a six-month to one- or-two year period following program participation. While still dominated by employee self-assessments, this phase should also include some third-party evidence of changes in behavior.

Long-term metrics shift the focus on measures that really matter. These are behavioral changes that are likely to increase long-term financial security, especially for those segments of the employee population who were identified as most at risk during the research phase of the program. Few programs have yet attempted to document the link between financial planning programs and desired employee behavior. Longitudinal studies are especially needed here.

Ideally, program champions will provide ex-

ecutive sponsors (e.g., the senior human resource executive and/or the treasurer or chief financial officer) and senior management with estimates of return on investment. Directional progress and trends are more realistic in the early going than hard correlations or claims of causation. When all is said and done, however, a sustained program will need to quantify the extent to which employees are positioned for long-term financial success. Actual success is the best protection against future challenges.

Modification of Deliverables

Programs need ongoing reassessment and refreshing. Employee demographics and environments change rapidly. Every element of a program—from content to style of delivery—needs to be reexamined regularly with an eye toward continuous improvement.

Cost Adjustments

Senior management will expect costs to decrease as a program matures. In fact, however, costs may increase as program usage goes up. Distinctions need to be made among (a) one-time start-up costs that disappear in future years, unless they are amortized; (b) fixed costs that change on a per capita basis as the employee base fluctuates, especially as a result of downsizings or mergers and acquisitions; and (c) costs that change due to actual usage by eligible employees. The latter includes costs that change as a result of provider performance measures, which are becoming much more common. Employers need to strike the right balance between predictable costs and those that will vary due to results.

CONCLUSION

Too many employers appear to be taking a wait-and-see attitude when it comes to initiating a credible employee financial planning program or enhancing their existing activities. I sincerely believe that this is a serious mistake, especially in the midst of talk of a looming national retirement crisis and a politically charged environment. A sustained proactive program—one that targets patterns of behavior posing the most acute risks to the financial success of employees and employers alike—is needed now more than ever. 