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BUILDING PARTICIPANT CONFIDENCE IN A CHALLENGING MARKET ENVIRONMENT

Stock markets go up and down, often catching participants by surprise in both directions. While stock returns have historically been more positive than negative, the negative returns tend to be much more painful. In fact, studies in behavioral finance have found that investors feel the "pain" of a loss as much as four times more than the "joy" of a gain. Given the events of late 2008 and early 2009, there is considerable concern, confusion, and fear among our participants. Two keys to helping them successfully weather the storm are communication and education.

Proper plan design and appropriate investment options are the long-term solution to participants' retirement needs. To keep participants focused on the long term, communicating early and often is essential. In this publication, NAGDCA will share some thoughts on the following questions to help you build or fine-tune a communication and education strategy:

- What should plan sponsors know?
- What are the participant behaviors to watch for?
- What messages are helpful?
- Where can you turn for resources to meet the challenge?

We don't have all the answers, and neither will you, when it comes to participant anxiety about market volatility. What's more, the answers have changed over the years — for example, products like target-date funds have altered the decision making that is required of participants. Regardless, even as the world of defined contribution (DC) retirement plans evolves, communication and education remain essential ingredients of any successful plan.

WHAT SHOULD PLAN SPONSORS KNOW?

To establish an effective communication plan, it helps to be clear-minded and well-informed in several areas:

The role of your plan — Seems simple, but think about the plan in the context of your employees' total benefit package. Is it still a purely "supplemental" plan? Or is it part of a core retirement program? The role of the plan, and other resources available to meet retirement income needs, can dramatically impact the way a sponsor should communicate in times of market volatility or unease.

The markets — An informed plan sponsor is best positioned to address the emotions of participants during uncertain times. There never is a crystal ball to see into the future with, but understanding history goes a long way to providing context for current environments. Know the history of capital markets as well as you can. For example, after a year like 2008, historical perspective is essential — for you and your participants. It was the second-worst year in the S&P 500's history. While there's no guarantee we won't see another year like it soon, it is worth reminding plan participants of the fact that it was such an outlier, historically speaking (**Figure 1**).

Participant allocations — It is important to know how your participant population is allocated among the investments in the plan. Work with your plan administrator to analyze the data — by age, job type, income and location, for example. Look for patterns or particularly challenged groups. The information will help you efficiently target key messages.

FIGURE 1: MORE POSITIVES THAN NEGATIVES: 2008 STANDS OUT AMONG DOWN YEARS

S&P 500 Index 1926 through 2008 | Positive Years: 59 (71%) | Negative Years: 24 (29%) | Average Annual Total Return: 9.6%

% Total Return	-50 to -40	-40 to -30	-30 to -20	-20 to -10	-10 to 0	0 to 10	10 to 20	20 to 30	30 to 40	40 to 50	50 to 60
							2006				
							2004				
							1993				
					2000		1988	2003	1997		
					1990	2007	1986	1999	1995		
					1981	2005	1979	1998	1991		
					1977	1994	1972	1996	1989		
					1969	1992	1971	1983	1985		
					1962	1987	1968	1982	1980		
					1953	1984	1965	1976	1975		
					1946	1978	1964	1967	1955		
				2001	1940	1970	1959	1963	1950		
				1973	1939	1960	1952	1961	1945		
			2002	1966	1934	1956	1949	1951	1938	1958	
		2008	1974	1957	1932	1948	1944	1943	1936	1935	1954
	1931	1937	1930	1941	1929	1947	1926	1942	1927	1928	1933

Past Performance is not indicative of future results. Source: Morningstar Ibbotson

The tools available — What are the tools you can offer participants to cope with volatile markets and which, if any, do you want to focus on? Every option has pros and cons. Stable value funds can lag inflation. Bond funds can have negative returns. Advice engines can help, but they can be expensive for you and complicated for your participants. Balanced funds and target-date funds can vary widely in how they balance return objectives with stability. It is most important to have multiple tools and let your participants know about each – with the possibility of targeted communications on each tool.

WHAT ARE THE PARTICIPANT BEHAVIORS TO WATCH FOR?

It isn't enough to simply give participants information and hope they'll know what to do with it. After years of providing basic investment education to plan participants with little measurable result, that point is clear. Instead, participant communications have to reflect and be designed to influence typical participant behaviors.

There are three important participant behaviors to track:

- When participants stop saving or reduce their deferral rates
- When they redirect contributions to more conservative options
- When they redirect their entire portfolios to stable value or cash

Half the battle is knowing how significant each behavioral challenge is within your plan, and who has taken each action. Again, work with your plan administrator to gather and analyze this information.

It also helps to have a basic understanding of the study of behavioral finance, which can form your participant communications strategy. For example, "anchoring" is a

MATCHING PARTICIPANT BEHAVIORS WITH KEY MESSAGES

Messages for those who stop saving — Emphasize tax benefits and long-term effects of compounding; as a last resort, keep participants in the plan at some minimum contribution level

Messages for those who redirect to more conservative investments — Promote benefits of dollar cost averaging; review the purpose of participants' plan savings and stress the long-term time horizon; review longer-term results and market recoveries from previous downturns

Messages for those who move to cash — Discuss the "sleep-at-night" test; review the purpose of the plan (retirement); suggest alternative solutions (pre-mixed portfolios like target-date funds)

common behavior in which investors link their decision making to a specific, and perhaps inappropriate, fact or event — making an investment decision for a long-term period (e.g., 10+ years) based on a two-year sampling of market performance. Participants also often engage in "mental accounting," making contribution or asset allocation decisions based on incomplete or inaccurate perceptions of their accumulated wealth or investment performance. The more you know about such tendencies, the better positioned you can be to provide effective, targeted education that can truly modify participant behavior.

WHAT MESSAGES ARE HELPFUL?

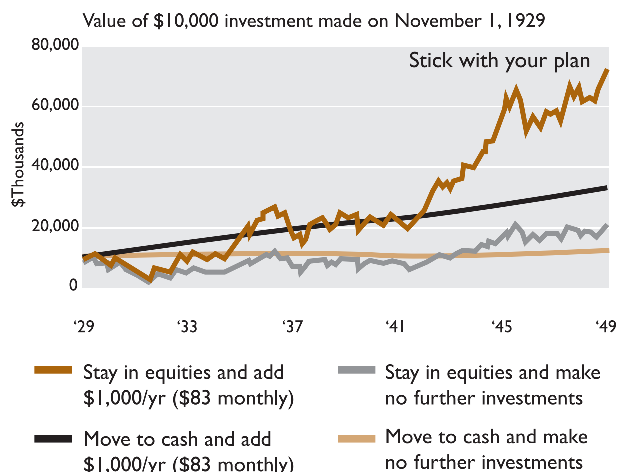
Start with the Basics

Education and persistent communications are still good weapons against the psychological barriers to effective retirement saving, particularly if the tone and content emphasize simplicity, clear choices, and the basic benefits of long-term planning. Since procrastination around retirement plan investing is so frequently based on risk aversion, communicating the availability of fixed asset allocation options or the ability to assemble a portfolio mix that aligns with a participant's age and personal risk tolerance goes a long way. It can also help to define and reinforce the amount you as the employer kick in (if any), which keeps participants from feeling that future security is solely up to them.

Clearly demonstrating the power of compounding — the idea that earnings can potentially begin to "snowball" — can be a very compelling incentive. The secret of putting compounding to work, participants must be reminded, is starting to contribute early. A chart showing how a 10-year delay between participants who contribute the same amount can mean five- or even six-figure differences in total savings after 40 years is very convincing. Explaining what "tax-deferred" signifies (i.e., a bottom-line boost from day one) could easily counter the most frequent objection: that participants "can't spare the extra cash right now."

Last, but not least, is the reassurance that thinking long term can elevate peace of mind. Although in the short term, the market may swing between highs and lows, it has historically been steadier over longer periods. For example, over the 83 years ended December 31, 2008, the S&P 500 Index experienced 59 years of positive annual returns and 24 years of negative returns. The average annual return for the entire 83-year period was 9.6%. Staying invested through the downturns may pay off over time. In **Figure 2**, we look back at an era of extreme volatility: the two decades following the market crash of 1929. The 1930s witnessed six years where the S&P 500 either rose or fell by 30% or more. During this tumultuous period, investors who continued to dollar cost average (invest the same amount every month), whether in a conservative Treasury bill investment or in an all-stock investment, boosted their savings compared to those who stopped saving altogether. It took years to accomplish, but those who maintained a diversified equity investment were ultimately rewarded.

FIGURE 2: THOSE WHO STAYED COMMITTED TO EQUITIES WERE ULTIMATELY REWARDED



Monthly returns based on investment in S&P 500 or 6-month Treasury Bills. Index performance is provided as a benchmark and is not illustrative of any particular investment. An investment cannot be made in an index. Past performance is not indicative of future results.

Source: Morningstar Ibbotson

Other key messages may include:

- **Take the sleep-at-night test —** Especially for true supplemental plans, when educating participants about reviewing their portfolios, encourage them to give their investments the 'Can I sleep at night?' test. If the answer is no, it is probably time to make the portfolio more conservative. That's an easier message to deliver when the plan is supplemental.

- **Know when you'll need your money** — Whether it's 10 years or 40 years from now, the answer should be matched against long-term historical data that shows the average returns for different types of investments *and* both the best and worst one-year returns. A participant has to believe he or she will be comfortable in that worst year. Comfort is often achieved when the investment type matches the time horizon of the investor. It may help if this point is accompanied by a simple chart or table showing that the gap between best and worst returns gets smaller the longer the timer period (**Figure 3**).

- **Diversification is the best portfolio strategy** — Allocating to stocks, bonds and cash has always been a tried and true approach to investing. In the 1990s, the cash allocation seemed to be forgotten. But it is the best stabilizing force for any portfolio (although participants must understand that with

reduced volatility comes more inflation risk). Again, the value of diversification should be illustrated by some simple charts and graphics.

- **Retirement income will be drawn from multiple sources** — If the plan is truly supplemental, remind participants of their traditional defined benefit (DB) plan and how that benefit works. Encourage them to think about the entire retirement income picture — Social Security, the DB plan, and the DC plan.

- **Market timing is best left to the pros** — And even they don't always get it right. Participants must be reminded that market timing is nearly impossible. Taking advantage of dollar cost averaging can remove the guesswork from investing and provide a more meaningful strategy than simply avoiding stock investments.

WHERE CAN SPONSORS TURN FOR SUPPORT?

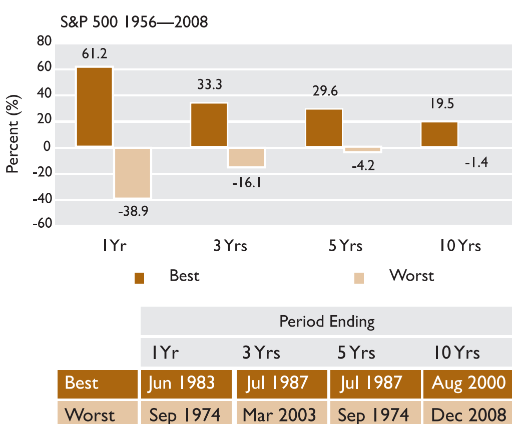
There is an abundance of resources available to plan sponsors for both general investment education and targeted messages for challenging markets.

- **Start with your current administrator** — There are many administrators who provide targeted education to participants based on specific criteria like average account balance, gender, and years to retirement. **People learn differently, and targeting messages to participants is most effective because it brings the right message to the right person in the right way.** Ideally, the message should be simple, inspire action, and may need repeating.

- **Ask your investment managers** — Look at your current line up of investment managers. Check their web sites. Many investment managers have general education resources available to clients and some are willing to tailor existing pieces or create new pieces to meet client needs. Chances are, if you need it, other sponsors do too.

- **Consider industry resources** — There are many industry resources available to provide plan sponsors and participants with ideas and guidance in tumultuous times. Examples include the Retirement Security Project *www.retirementsecurityproject.org/*, the Profit Sharing/401k Council of America *www.psca.org/*, the American Savings Education Council *www.choosetosave.org/asec/*, the Employee Benefit Research Institute *www.ebri.org/* and the 401k Help Center *www.401khelpcenter.com/*.

FIGURE 3: TIME CLOSES THE GAP BETWEEN BEST AND WORST RETURNS



	Period Ending			
	1Yr	3 Yrs	5 Yrs	10 Yrs
Best	Jun 1983	Jul 1987	Jul 1987	Aug 2000
Worst	Sep 1974	Mar 2003	Sep 1974	Dec 2008

The S&P 500 index consists of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe. Index performance is provided as a benchmark and is not illustrative of any particular investment. An investment cannot be made in an index. Past performance is not indicative of future results.

Source: S&P

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