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Millennial Savings Plans –
Is Your 401(k) Ready to Adapt?

Today's workforce is uniquely shaped in a way that we haven't experienced before. Some workplaces may be employing people representing as many as four different generations – Baby Boomers, Gen X, Gen Y, and Millennials. And while some of those generations are on their way out or moving up, Millennials, which will make up half the global workforce by 2050, are the ones employers are trying to attract and retain.[1]

As Millennials join the workforce and plan sponsors wrestle with their needs and wants, their employment trajectory has also changed. Workers are no longer at the same job for 20 or 25 years with the promise of a Defined Benefit (DB) pension plan at the end of that career. Today's Millennial worker moves from job to job in a shorter amount of time. Loyalty to one company is not a priority. As well, the "gig" economy where workers work for themselves from contract to contract has also changed the attitudes of workers and how they view their careers. To a certain extent, time and flexibility, lifestyle, and mental health have usurped salaries and money as the primary focus.

These changing economic issues pose a direct challenge to plan sponsors looking to attract and retain workers. One tool that has been a relatively sound perk for employees looking at their next job has been the 401(k) or Defined Contribution (DC) plan. But with the changing economic landscape, plan sponsors need to grow and evolve their 401(k) plans, in terms of their design and ability, if they want them to appeal to the next generation of workers.

The good news for plan sponsors is that Millennials as a group are interested in savings. A study by the TransAmerica Center for Retirement Studies says that the saving habits of Boomers, Gen Xers, and Millennials are relatively similar.[2] If anything, Millennials have a slight edge on their older

35
The age **Baby Boomers** start saving

30
The age **Gen Xers** start saving

24
The age **Millennials** start saving

[1] "Workforce of the future," PWC. https://www.pwc.com/gx/en/services/people-organisation/publications/workforce-of-the-future.html
[2] "What Is "Retirement"? Three Generations Prepare for Older Age," TransAmerica Center for Retirement Studies. https://transamericacenter.org/docs/default-source/retirement-survey-of-workers/tcrs2019_sr_what_is_retirement_by_generation.pdf

counterparts. The study shows that, on average, Millennials start saving for retirement at age 24, younger than Gen Xers, who started at 30 and Baby Boomers who started at 35.

Not only that, Millennials generally put about 10% of their salaries to a company-sponsored savings program, the same as Boomers and more than Gen Xers.

What Millennials Want

Takeaway:
Millennials are looking for options, ease, and flexibility to reflect their lifestyles. To help them succeed, they need a strong education in retirement savings to help them maximize their retirement savings while avoiding pitfalls.

Digging a bit deeper helps us understand the differences between Millennials and other generations' attitudes towards savings – which, when considered, will make the design of a Millennial-friendly 401(k) plan easier to navigate.

In the past, plan sponsors would talk to their employees about the "three-legged stool" of retirement. One leg of the stool is personal savings, the other is a company pension, and the third is government assistance like Social Security upon retirement. That system worked for a time, but the notion has quietly died off as economics, employment habits, the costs of pensions and perceptions have changed.

As the population gets older, there is a perception that Social Security is not really secure at all. Many see it as unpredictable as a future savings nest egg (or at least portion of a nest egg) and are skeptical of its stability one or two generations from now. Assuming Congress makes no changes, the Social Security Trustee says benefits can be paid well into 2037 and beyond, while continuing taxes will be able to help pay 76% of payouts. Not the vote of confidence the public would like to hear, but not quite the end of the world.

Because of issues like the gig economy, Millennials need to save more and be more creative with their savings if they want to maintain that flexible lifestyle in retirement. Millennials also want a different lifestyle when they are older, spending less time working and prioritizing giving back, with less stress and more freedom than previous generations.

If employers want to attract and retain Millennial workers, and they see 401(k)s as one vehicle to do so, there has to be a sea change in their thinking about plan design. And despite their willingness to save for retirement, many Millennials are not using 401(k)s in as effectively as they could.

Personal debt is eating into savings

1/3 of **Millennials** have taken out 401(k) loans

1/4 of **Millennials** have taken an early withdrawal

About a third of Millennials have taken out a 401(k) loan, while roughly a quarter have taken an early withdrawal.[3] Personal debt is eating into savings, which can be a vicious cycle if not addressed early on. Retirement savings can be misunderstood if the funds are viewed as bank accounts that can be used today rather than for the future.

Knowing what we do about Millennials' characteristics, plan sponsors have to focus on educating the new workforce about retirement savings and explaining why it is so crucial to their future goals and aspirations, especially in a trajectory that never stands still.

Plan Design Ideas

Takeaway:
Many plan sponsors don't currently offer auto-enrollment or auto-escalation features in their plan. This creates a big opportunity for organizations that want to attract and retain competitive talent and make their businesses better and more stable over the long term.

Millennial workers, and perhaps most Gen Xers for that matter, do not have a strong sense of DB versus DC plans and what their strengths and weaknesses are. In the not-so-distant past, workers were provided a pension after working a lifetime with one company with the promise that their company would pay a defined benefit upon retirement.

[3] "Millennials Are Making This Major 401(k) Mistake," The Motley Fool. https://www.fool.com/retirement/2019/04/11/millennials-are-making-this-major-401k-mistake.aspx

These were simple plans that didn't require the employee to make any savings or investment decisions.

With the advent of the 401(k) and/or DC plan, younger workers had to consider their retirement more as the company promise was reduced to monthly matches depending on contributions by the worker. Investment options and decisions were left to the workers themselves. Savings, the rise and fall of the stock market, management fees, financial planning, and myriad decisions are now part of the retirement savings equation. While this benefits the plan sponsor in some ways, progressive organizations recognize this makes life more complicated and stressful for the employee. Millennials entering the workforce have to consider things they perhaps never considered before.

By using the 401(k) plan as a benefit and adapting its design to meet the needs (and attitudes) of Millennial workers, plan sponsors can attract and retain employees who seek out flexibility and diversity within their careers.

Automate

One element of plan design that not only encourages greater participation, but also helps increase contribution rates, is the notion of auto-enrollment. Simply, auto-enrollment is a feature in retirement savings plans in which employees are automatically enrolled to contribute a certain amount of their salary each paycheck. Typically, employers take a 3% contribution from employees' wages and put it towards their retirement savings. Many employers will often match those contributions depending on the robustness of the plan.

While 3% has been the standard for some time, the thinking within the industry is starting to shift, with some of the more progressive organizations seeing auto-contributions of 5% or 6% as being the more optimal numbers. Given Millennials' willingness to save, the higher contribution levels may be a welcome change.

With auto-enrollment, plan sponsors often give their employees a place to park or invest their money. Typically, a default investment option is offered to help get employees started. Employers who want to limit their fiduciary liability, but make the choice easier for employees, will choose lifecycle funds or balanced funds that are designed to help employees earn enough of an investment return to retire while taking the appropriate amount of risk for their age. Default options also give plan members who are not investment-savvy, or who are uninterested in becoming investment experts, the ability to invest with fewer headaches and concerns about options.

Auto-escalation is another feature more plan sponsors might want to consider when trying to attract Millennials. With the auto-escalation feature, plan sponsors will automatically increase employee contributions over time and can reach levels of 10% or 12% of their salaries. Auto-enrollment and auto-escalation can work nicely together. Saving automatically is an attractive feature, but if the savings are not reaching levels that will help secure a steady income in retirement, the plan is not doing its job. That's why having the two together can be additive to long-term savings goals.

Investment Menu Design

Takeaway:
Millennials are saving more and want more choices. Plan sponsors that want to engage with this generation need to offer Roth contribution features and a combination of active and passive investments.

Getting people to contribute to the plan, either through good marketing or auto-enrollment and escalation, is a start. But what about the investments themselves? Savings over time have to be diverse, weather economic storms, and ensure that members of the plan grow their 401(k) plans to a level that will fit their lifestyle needs and goals in retirement.

There are myriad savings vehicles for plan members to invest in and for plan sponsors to offer. Investments can be passive or active. They are not mutually exclusive and complement one another. Plan sponsors should consider both options for a modern 401(k) plan that can attract and retain employees.

A Closer Look at the Investment Menu: An Example

While investors require plans tailored to their needs, here is a hypothetical break down of the various investment options and how they can combine passive and active strategies to help meet a diverse range of plan member objectives:

At the core

- Core set of passive options that have less management oversight, can include large-, mid-, and small-cap equity funds
- A passive core fixed income
- A passive core international option to add diversification and growth potential

Specialized mandates

- Complementing those choices, plan sponsors should also offer between 14 and 16 active strategies in all other asset classes that may be more specialized
- To round out the menu, consider a default lifestyle or target-based fund (based on retirement date or risk) that gives plan members diversification, without having to rebalance their portfolio continually

Each plan is unique and we recommend a thoughtful and bespoke approach to investment menu design to ensure it meets the needs of your organization and member base.

Given the nature of the Millennial psyche, plan sponsors should also consider investment funds that address socially responsible or environmentally responsible investing – also referred to as ESG (environmental, social, and governance) funds. Assuming it fits the culture and values of your workplace, it is a wise addition to the investment menu, knowing the priorities of Millennial investors.

Roth 401(k) plans will also appeal to Millennials. Since the funds are invested with after-tax dollars, the savings are tax-free upon withdrawal. Given Millennials' general willingness to save, it's reasonable to expect a material portion of this demographic will find themselves in a higher tax bracket when they retire. As such, being able to compound their savings tax free and make tax-free withdrawals in retirement will greatly increase their income stream later in life.

Structural Changes

Takeaway:
Between the recently announced legislative changes and other features, plan sponsors have much more flexibility to develop more robust 401(k)s tailored to Millennials. Plan sponsors that allow members to combine funds from previous employers and allow them to access their information on-demand will have an advantage of attracting and retaining Millennial employees.

With investment options and contribution rates in place, plan sponsors need to look at their 401(k) plans from the eyes of the Millennial themselves. Many move from job to job, work on contract and don't necessarily spend a career at one employer.

Fortunately, the new Setting Every Community Up for Retirement (SECURE) Act, which was signed in late 2019, gives plan sponsors more latitude to cater to Millennials.

The tax legislation gives retirement savers a more robust toolkit to save for retirement, which is particularly important as Americans live longer and take increasingly diverse paths to retirement.

As with any piece of new legislation, there are always pros and cons to consider. On balance, we see the SECURE Act as offering some significant steps on the government's part toward the tax treatment of retirement plans. Some of the highlights include:

IRA contributions past 70½

The long-discussed extension of the required minimum distributions (RMD) requirement from age 70½ to 72 for 401(k) plans is an important component of the new Act. The change takes into account the increase in longevity over the past 20 or 30 years to more accurately reflect that people are living longer. By pushing the age back to 72, it means Americans will be able to increase the tax efficiency of their investments, especially if the individual doesn't require the added funds in those early retirement years. By leaving the funds in the IRA longer, individuals can increase the tax efficiency of their investment and lower the risk that they will exhaust their funds in retirement.

Mandated lifetime disclosure of income

One provision in the *SECURE Act* that shouldn't be overlooked is the new mandatory quarterly reporting requirements. This information is essential since it will allow plan sponsors to work with clients to help them understand how much they need to accumulate over time to cover their monthly expenses. Millennials, who want to be more involved in their savings decisions, will likely welcome this change since it will allow them to see how their retirement income compares to their current expenses.

Enhanced auto-enrollment plans

Notably, the *SECURE Act* also makes it easier for small businesses to set up automatic enrollment in 401(k)s for their employees. At the same time, by allowing employers to increase the qualified automatic contribution arrangement (QACA) to 15% — which is well above the current 3% contribution levels —there is a better chance those Americans will have a well-funded retirement.

Outside of the recently introduced changes, allowing participants to bring assets in and out of other plans, into their current plans, would make it a more attractive option for Millennials. Consolidation of funds from previous employers and having retirement accounts in one place will make investment decisions easier and give you an edge on other plan sponsors who may not have these types of structural benefits in their plans.

Another structural change that gives plan sponsors an edge on the competition is technology. Millennials have grown up with devices in their hands. Having a 401(k) plan that can be accessed through mobile devices is a definite step in the right direction. Not all vendors have full optimization for members to make changes through their phones, but the ones that do will have an advantage with this generation.

Educating Millennials on 401(k)s

In an ideal world, the power of a 401(k) plan should speak for itself. Unfortunately, many employees don't necessarily see its value immediately and need prodding or some education as to why it is so important.

Long-term planning is at the core of a 401(k) plan's benefits. Assisting your workers by helping them understand this important fact will help them today and into the future. There are different ways to educate. Many plan sponsors have welcome packages, lunch-n-learn sessions. In today's world, digital or AI advice and robo-automated solutions are more in vogue. Still, face-to-face meetings where people can ask questions and build a rapport with someone, over time, works quite well and is often preferred.

Even more so than call centers, personal attention can help plan members better understand their own needs, risk tolerances, and how retirement savings can work for them.

Of course, part of that one-on-one attention can address financial literacy concepts, such as the power of compounding and pre-authorized contributions, how the plan itself works (especially when changes are introduced over time), and generally, the importance of retirement planning and retirement income.

Procyon Partners is always looking for tangible ways to add value for our clients. We're pleased to provide this educational piece on 401(k) plans so you can better attract, retain, and understand the savings needs of Millennial workers.

Given these evolving trends regarding plan design for the next generation of workers, this is a good opportunity to connect with an experienced plan advisor who can help implement change. If we can be of any help to your tailoring your 401(k)s to Millennials, please contact us.

Call (844) PROCYON today

Do you need alternative options for your retirement plan? Contact us to learn more about how Procyon can help your firm prudently manage your retirement plans.

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