6 ways employers plan to change 401(k) plans

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Many employers are tweaking their 401(k) investment options, typically reducing the number of funds available and adding low-cost index fund options. They're also increasingly looking for ways to convince workers to save more and make more appropriate investment decisions. Here is how companies expect to adjust their 401(k) plans in the coming year.

Fewer investment options. Many 401(k) plan sponsors are planning to reduce the number of investments offered to participants. The proportion of plans offering 20 or more investment options has declined from 31 percent in 2010 to 26 percent in 2014, according to a Towers Watson survey of 457 large and midsize U.S. companies that sponsor 401(k) plans or similar types of retirement accounts. About two-thirds of plans now offer between 10 and 19 investment options. And 19 percent of companies plan to remove or replace investment options in the next 12 months. "If you have fewer funds, the company can do a better job monitoring them and make sure that they picked the best funds," says Robyn Credico, defined contribution practice leader at Towers Watson. "Too many options confused employees." Only 6 percent of companies are preparing to offer a wider array of investment choices.

Adding index funds. There's an increasing amount of interest in adding index fund offerings to 401(k) plans. Some 22 percent of companies offer a tier of index fund options, up from 18 percent in 2014, and another 40 percent of employers say they are very or moderately likely to change some or their investment options from actively managed to index funds, according to an Aon Hewitt survey of 248 companies that sponsor 401(k) plans. "We've seen a number of plan sponsors use more of an index investment lineup or shift a higher percentage of their investment options to a passive or indexed approach," says Steve Anderson, head of retirement plan services at Charles Schwab. This switch to index funds might be motivated by reducing costs for participants because index funds tend to have lower expense ratios. The proportion of companies that have changed their fund lineups to cut costs grew from 27 percent in 2014 to 34 percent in 2015, and 34 percent of companies say they are very likely to select more inexpensive investment options in the coming year.

Higher fees for participants. Employers are planning to pass more of the costs of administering the 401(k) plan along to participants. The proportion of companies requiring employees to pay recordkeeping fees has jumped from 33 percent in 2009 to 58 in 2014, Towers Watson reports. Less than a quarter (23 percent) of employers absorb the cost of the recordkeeping fees, down from 58 percent in 2009. Some companies also split the costs with employees.

Automatic features. Most companies (68 percent) automatically enroll all or newly hired employees in the 401(k) plan, up from 57 percent in 2010, Towers Watson found. And 54 percent of companies provide an automatic escalation feature that increases employee saving rates over time until they reach a target savings rate selected by the plan. Another 21 percent of companies are considering adding automatic escalation to their 401(k) plans in 2015 or 2016.

"We're seeing a lot more employers adopt contribution escalation, which will have their savings rate move up automatically over time," says Rob Austin, director of retirement research at Aon Hewitt. "The time when it gets turned off is getting higher and higher. For a long time, it was 6 percent, but we are seeing more employers go up to 10 percent or 15 percent."

Adding a Roth option. A Roth 401(k) doesn't get you a tax deduction in the year you make the contribution, but withdrawals in retirement are often tax-free. More than half (54 percent) of employers already offer a Roth option, and another 18 percent of firms are planning to add Roth features to their 401(k) plan by 2016, Towers Watson found. However, the Roth option isn't particularly popular among workers, with only around 11 percent of employees using the Roth 401(k) feature.

More communication with participants. A majority of employers (84 percent) say they plan to increase efforts over the next two or three years to educate employees about saving and investing, Towers Watson reports . Much of this increased communication is likely to occur online rather than in person. Aon Hewitt's survey found that the proportion of employers offering online investment guidance increased from 56 percent in 2014 to 69 percent in 2015, and 18 percent of the remaining employers say they are likely to add this service within 12 months.

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