ACUMEN WEALTH ADVISORS

INVESTMENT OPTIONS: HOW MANY TO OFFER

Investments Are Like a Box of Chocolates

Many plan sponsors struggle with deciding how many investment options to offer in their retirement plans. While people generally like to have lots of options when making other decisions, having too many plan options can potentially lead to poor investment decisions by plan participants. In addition, increasing plan options can also increase plan costs, as well as the administrative paperwork associated with the plan.

In a study on retirement plan options, researchers concluded that it is possible to present plan participants with too many options.[1] The researchers began by offering people selections of jams and chocolates. Some were offered a wide variety, while others received less choices. The wide variety of jams attracted more attention from people, but more people purchased jams when offered limited choices. When sampling chocolates, people enjoyed choosing from the larger selection more, but also were more dissatisfied with the choices. Those who sampled from a smaller selection were more satisfied and more likely to buy chocolates again. In other words, as the number of options increased, people became more concerned by the possibility of making the "wrong" choice–they became uncertain that they had made the best choice possible.

Chocolates and jams aren't very big decisions, but the researchers found that these same behaviors carried over to retirement plans. They examined participation rates for 647 plans offered by the Vanguard Group, a large investment management company, covering more than 900,000 participants. They found that as plans increased the number of options they offered, employee participation decreased. In fact, for every 10 options added to the plan, participation dropped by 1.5-2 percent. Plans offering fewer than 10 options had significantly higher employee participation rates.

In addition, more plan options can increase costs both for participants, in the form of fees, and for plan sponsors, who may face additional administrative charges from third party administrators for additional options. Further, auditing and other costs may increase, since the number of options could increase the time necessary to conduct audits.

It's important to balance choice overload against the requirements of ERISA Section 404(c) which requires plan sponsors to have at least three diversified investment options with different risk and return characteristics.

[1] http://www.columbia.edu/~ss957/articles/How_Much_Choice_Is_Too_Much.pdf

Acumen Wealth Advisors
250 Forest Avenue
Chattanooga, TN 37405
(423) 825-4796
www.acumenwealth.com