

Hey Dude, That New Pension Protection Act is Sweet: *But Maybe Not For Retirement Dreams*

By Dennis Ackley

In a recent survey⁽¹⁾, two-thirds of respondents between ages 21 and 30 say they'd feel "grateful" or "optimistic" if their employers automatically enrolled them in a defined contribution plan. Perhaps some of these young people would want to send a thank-you note for the new law that makes them feel this way.

To the President and Members of Congress:

Thanks for protecting my dream for a big-screen TV!

I love having the latest electronics. Now, because of the Pension Protection Act, my dream for a huge big screen is about to come true – without me doing anything!

The new law is perfect for us who are in our twenties. We want to pay off credit cards and college loans and get better vacations, cars and electronics.

My new employer automatically puts me in the 401k. All I do to get my new TV is just take the money when I change jobs.

Nearly 80% of us in my age group change jobs in our first five years after college⁽²⁾. Obviously, all of you in Congress knew that. So you made the law so we'd get the employers' money out of the k-plan after just two years. Thanks for the extra bucks.

A guy in the benefits department says I'll have to pay taxes plus a 10% penalty on the money when I take it. But I say, "Whatever." Congress thought of that, too. Under the new law, my employer will put around \$2 in my k-account for every \$3 of mine that goes in. When I take the cash for my big screen, the money the company gave me will more than cover my taxes and that penalty.

The benefits guy says a k-plan is for my retirement pension. Right dude, I'll start thinking about my retirement dream when I'm old – like 50 or 60. Until then, the new law is sweet for helping me get what I want while I'm young.

Signed,

Millions of young people who have not yet discovered that the price of the future income they want following their full-time work will likely be the largest purchase they will ever make.

Intended or Not?

The new Pension Protection Act is intended to improve Americans' retirement security. Time will tell what it actually accomplishes. Unintentionally, it may put one of the final nails in the coffin of corporate DB plans. And inadvertently, that could fuel a backlash from some workers (taxpayers who have a frozen or no DB plan) to curtail public employers' DB plans.

We'll also see if the law helps individuals achieve their future financial dreams. Or if it simply creates larger cash outs at job changes, more loans among active employees, and too many small account balances that will fail to provide the future lifestyle workers want and need.

Legally Behaving the Right Way

The law approves some "automatic" 401k plan provisions that have been touted by behavioral finance scholars. In simple terms, these are plan design tricks that attempt to get employees to do what retirement experts consider are the "right things" in using voluntary retirement plans.

Let me be clear. There's no malicious intent behind the auto-everything fad – auto-enrollment, auto-contribution increases, auto-time-targeted investments, auto-rollovers, et al.

These should have been required 20 years or so ago when, with the stroke of a pen, the majority of 401k **Supplemental** Plans were renamed 401k **Retirement** Plans.

20 Years Too Late

That simple change completely altered the retirement world. It made most employees fully responsible for their financial future. But only the name changed. The plans were not redesigned to be the second leg – or even the only leg – of what was the "three-legged retirement stool." And nothing was done to ensure that employees had the knowledge they needed to take responsibility for

being successful in using 401ks to create their desired future lifestyle income.

Success Can't Come Automatically

Automatic plan design features alone can never accomplish what knowledgeable, motivated individuals can do to achieve their financial lifestyle dreams. Yet the knowledge that's essential to using a 401k successfully remains a missing element in the new retirement world.

In a few years, if most workers remain naïve about how to use 401ks successfully (a likely situation), will plan designers be back with ideas for auto-annuities, auto-long term care, and auto-reverse mortgages?

Behavioral finance experts offer valuable insight into understanding how humans do and do not act with money, investments and long-term financial plans. But when studying 401ks, behavioral finance provides little more than a picture of what naïve people do...or more often do not do. Based on that data, it's easy to see why these experts suggest that plan sponsors capitalize on naïve people's behavior (what some call "inertia power" – a polite term for "ignorance") to get employees to do the "right things." Again, done with good intentions.

Where's the Model for Success?

Isn't it odd that the behavioral finance fad – focusing on what naïve people do – is the main driver of today's retirement plan thinking?

There are other theories of psychology that could be applied. For example, the followers of B.F. Skinner, the famed proponent of behaviorism, would probably suggest that we study how **successful** people behaved in using 401ks to achieve their retirement dreams. Perhaps researchers would recommend using plan design features and educational tactics that would recreate the experiences the successful employees had so the "yet to be successful" employees would likely behave in a similar successful manner.

It's a virtual certainty that successful users of 401ks were motivated by a personal financial goal. That's something no automatic plan design feature can provide.

Plan sponsors' interest in automatic plan features may be due in part because they've seen expensive and time-consuming retirement education programs fail. Too many programs have not helped employees acquire the knowledge and motivation – and take appropriate action – to be successful.

Retirement Ed Needs Educated

Most retirement education content that's being used today was developed in the old retirement world. These programs rarely use adult learning principles. They don't help employees discover their personal financial lifestyle dream or determine the "price tag" for it. The programs were created by financially savvy people who want to **tell** the "not yet savvy" what to do. It's well-intended – but telling adults ain't teaching. Most adults will not simply do what they are told to do with their money. Teaching the "yet to be aware and motivated" about their financial future is far more complicated than just telling them what to do – even if what they're told is spot on.

But perhaps the biggest shortcoming of today's retirement education is that, unlike every other training program, it has no progress measures for each individual's success.

Measures matter – because what gets measured gets done. Yet in the new retirement world, plan designers and retirement educators compare what they do to what other employers do. The use of "benchmarking" and "best practices" provides valuable and useful measures for programs and products that work. But 401k retirement plans and education programs aren't working. So these measures simply institutionalize and perpetuate the failures. In a real sense, they provide a, "Your plan is not failing any worse than most other plans" measure.

If the retirement industry wants 401ks to be "retirement plans," then it needs to act like it. Plans and education programs must be designed with just one purpose – helping employees achieve their individual financial dreams. And measures must be created to track each person's progress.

Make the New Retirement World Work – Or Admit Defeat

It's time to stop relying on measures that are relics of the 1980s – such as overall plan participation and contribution averages. No doubt, auto-enrollment will increase the old world measure of plan participation. It may decrease the average contribution rate. But these measures don't show what matters the most – how well individuals are doing in defining, pursuing and attaining the future financial lifestyle they want.

If the retirement education community is incapable of helping people acquire the knowledge to be successful in using a 401k as a **retirement** plan, or if the majority of employees are unable to learn – or if employers are unwilling to provide the time and resources needed for employees to learn – then Congress should outlaw “401k **Retirement** Plans.” Perhaps a new law could require 401ks be renamed to reflect what they actually are: “The Maybe Get Some Money When You Quit the Company Plan.”

Our country cannot afford to allow millions of workers to remain naïve about the reality of their retirement. They must be helped to discover the cost of the future lifestyle they want – the sooner the better. They must also discover and understand the steps they can take today to start **buying** that lifestyle.

In the new retirement world, retirement is a consumer item. The question is will plan designers and educators find effective ways to help people purchase the future lifestyle they want?



Endnotes

- (1) *Fifth Annual Workplace Report on Retirement Planning*, Prudential Retirement, November 2006.
- (2) *2006 Life After College*, Experience, Inc., August 2006.

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For 20 years Dennis Ackley has been an advocate for clarity and accountability in retirement education – helping workers gain the knowledge to achieve the financial future they want. His award-winning communication programs on retirement, investing, and health care have reached three million employees at hundreds of employers. For more articles and more information, visit www.DennisAckley.com.

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