The 401(k)'s failings
Problems go well beyond those Enron exposed

By Justin Wiser, CBS.MarketWatch.com
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WASHINGTON (CBS.MW) - Twenty years after their creation, the 401(k) has evolved from a loophole-exploited tax break into Americans' chief retirement-savings vehicle - and it's failing in that role well beyond the ways that Enron's collapse exposed.

With roughly $1.8 trillion in assets, 401(k)s will soon surpass the $2.1 trillion in traditional pension plans, according to research firm Cerulli Associates. Yet these retirement plans are fraught with systematic problems, from low participation rates and minimal balances among millions of contributors to limited investment options, high costs and little oversight.

"No one was complaining about things a few years ago because they were making so much money," said activist **Dennis Ackley**, whose Ackley Associates firm develops retirement-education materials.

While high levels of company stock in plans remains a serious issue, as evidenced by Enron's collapse, observers point to other, more fundamental flaws as well. "We need to make changes beyond what's being talked about," agreed Ted Benna, president of the The 401k Association and a creator of the 401(k) plan.

Among the major flaws of the 401(k) retirement plan system:

- Low participation: One in four eligible employees don't participate in their employer's plan, according to Hewitt Associates. Many workers also have to wait a year or more to enroll in a 401(k). Among low income and younger workers, the problem is especially pronounced, **Ackley** said.. For instance, half of those under age 30 are not participating - and they're exactly the group that would benefit most from the 401(k)s' touted "miracle of compounding."
- Low account balances. The mutual fund industry points to the success of 401(k) plans by noting the average balance is $50,000. But as **Ackley** points out, that's inflated by more-highly compensated participants' savings levels. The median balance - the midpoint at which half are above and half below - is just $14,000. The same holds for people age 60: The industry touts their $115,000 average balance, when the median is $50,000, **Ackley** said. A 7 percent annual return on $50,000 would give a person less than $300 a month to live on in retirement. And of course, all the average balances are for those in a plan - it doesn't include non-participants.
- Portability backfires: Workers can roll over assets to a new plan when they switch jobs, yet the majority of workers under age 35 take a lump-sum payment in cash, which faces taxes and a 10 percent penalty. "You ought to be required to leave the money there or roll it over," Benna said.
- Limited investment options: The average 401(k) participant has 10 investment choices in his or her plan, a far cry from the thousands of mutual fund choices available in the open market. Employers can invest traditional pension funds almost anywhere they want, but their employees have highly restricted options with 401(k)s - and often downright bad ones. "Why should I be held captive in the funds my employer has picked?" queried Benna.
- High costs: In a 1999 Hewitt survey, 71 percent of plan managers said they do not even bother to calculate the total cost of maintaining their 401(k) plan. "My guess is that in 75 percent of plans, investors get retail mutual funds at regular prices or worse," Benna said. Participants are not getting a bargain on the investment side, even though the plan is pooling assets.
- Poor disclosure: The majority of plans polled by Hewitt do not disclose either administrative fees or investment management fees to participants unless requested.
- Poor management: "Most employers are not well-equipped to pick the investments they choose for their employees," Benna said. Often, HR professionals or business owners with no investment experience are left to dictate the terms of their plan.
- Little government oversight: To promote diversification, traditional pension plans are required by law to invest no more than 10 percent of assets in one stock, yet 401(k) plans face no such rules. "We require auto passengers to wear seat belts because many won't do so voluntarily," Benna said. Traditional pension plan assets also must be insured, unlike 401(k) savings.

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