This article is intended to be a 'thought starter.'
The information is meant to generally represent typical 401(k) plans – not to be precise or to represent any specific plan.

When Will the Secret of 401(k)s be Exposed?

Most Employees Know Too Little to Succeed

By Dennis Ackley

Recent congressional hearings stemming from the Enron fiasco put 401(k) plans under scrutiny for the first time.

Although the resulting legislation may not be overly onerous, what about the next time? There's bound to be another negative 401(k)-related issue lurking. There's just too much – or too little – money at stake for employees (voters). Will Congress be as gentle the next time? Will the 401(k) benchmarks and success measures – mostly antiques from the days these plans were 'supplemental' to defined benefit pension plans – meet the next challenge? Or could sponsors of 401(k) plans end up with a nightmare that goes something like this ….

Without retirement education outcome measures, how will plan sponsors know if they are achieving the plans' strategy – helping employees define and achieve their personal retirement dreams?

Ms Smith, we're delighted you're here. In previous testimony, we've heard that in voluntary, employee-directed retirement plans – like your 401(k) plan – employees must know how to use them to be successful in achieving their retirement dreams. We invited you here because you're responsible for running a typical 401(k) retirement plan.

Senator, it's a privilege to be here to tell you how 401(k) plans are helping employees retire.

Ms Smith, I see in your written summary that nearly a third of all your employees – mostly lower-paid – are missing company-matching contributions because they don't participate in your plan. I'm equally concerned that roughly half your eligible employees under age 30 aren't participating. So they're also missing the opportunity for what's been called the 'miracle' of long-term compound earnings. Do all your non-participating employees understand what they are missing?

I don't know for sure. I hope so.

In your report you point out proudly that your plan's *average* account balance is around $50,000. Yet when we dug into your numbers, we found that half of your participants have less than $14,000. And these amounts don't include the zero balances of the third of eligible employees who aren't participating. Is that right?

Well, yes, but Senator, I thought I was here to focus on what we're doing well.

I'm sure that's what you thought. In fact, in your report you point out that your employees at retirement age – age 60 and older – have an average of roughly $200,000.

Yes. And I'm proud to say that some are much larger.

I'm sure. I'll bet they belong to higher-paid employees. What I'm seeing is that averages in 401(k) plans seem to hide more than they tell.

Perhaps, but….

Pardon me. Isn't it true that half of your employees who are close to retirement – those over age 60 – have less than $50,000?

Well, that's probably right.

Ms Smith, you're a retirement expert. So I'm sure you've seen various retirement payout models. Those models usually show that to be quite certain of having retirement income that lasts as long as you live, you can take out only about 4% or 5% of the initial account balance each year. That means an employee who has $50,000 in an account at retirement can count on under $2,500 a year for life – that's around $200 a month. Does that sound about right?

Yes.

Do your employees understand this?

That's not included in the education we provide. Most employees would probably guess they could take out over twice that much for as long as they live.

Let's look at what else you don't teach your employees. You say an attractive feature of your plan is what's called portability. Employees can take their vested account when they leave the company. Yet most of your employees under age 35 take the cash, pay the taxes plus a 10% penalty, and lose forever the opportunity to use that money for retirement. Why is that a good feature?

Well they should have known not to spend it.

There seems to be a lot your employees should know but they don't. For example, surveys show that roughly half the participants don't know they're fully responsible for their retirement investments. I'd say it's essential that all employees in a voluntary retirement plan know that. Do all your employees know that?

That's not something we measure.

I have a friend who's a pension actuary. She tells me the first step in planning the funding for pension plans is to have a clear retirement benefit income target. Are you aware of that?

Yes, that's right.

So you and other experts say having a target is step number one in retirement planning. Then why do half the employees who are age 65 and older – the 'graduates' of our retirement education system – have absolutely no idea how much money they'll need for retirement? They can't even offer a guess … like, "Gee, if I spend $20,000 a year for 20 years – say from age 65 to 85 – that's around $400,000." Would it be fair to say that most of your employees have missed the first step – they haven't set their personal retirement benefit target?

That's probably true. But again, we don't measure that.

I see you have a degree in finance. Me too. I remember taking a couple semester-long classes on investing. Is that what you did?

Yes.

In your report, you say that you provide employees with one-hour meetings when they sign up for the plan. And you send out a few newsletters each year. I assume this is to help your employees become proficient in using investments for their retirement. So what took you and me many months of study in college courses that we wanted to pursue, you provide in a few minutes to people who probably don't share the interest or background knowledge we had. Isn't the employees' investment knowledge critical in determining how successful they'll be in accumulating their retirement income? Would you agree with all that?

I guess I'd say so.

Wow, if our professors had used the sophisticated and efficient teaching techniques you're providing your employees, we would have gone through our investment classes in a flash.

I'm not so sure the techniques we're using are … well, never mind.

One of the things I remember from my college courses is that retirement investments need long-term horizons. For example, a 30-year-old may not be taking money out of a retirement account for 30 or 40 years. But I see you offer both Internet and phone access 24 hours a day, free of charge, to let employees trade their mutual funds every business day.

Yes. That's what most plans do.

That sends a mixed message doesn't it? By the way, I don't know of any Wall Street investment firm that does day trading in mutual funds. Yet that's what your plan offers. Isn't that an odd approach?

Employees always want more choices and flexibility. That's what we gave them. It makes them happy and it's easier than trying to teach them what they need.

I'd hate to think that your role as a plan sponsor is to keep employees dumb and happy. Anyway, let's look at the account statements you send out every three months. They focus on current investment performance. Same with your plan's website. Neither tells employees how they're progressing toward their retirement goal. Aren't the accounts supposed to be for retirement?

Well, yes.

Ms Smith, in surveys we've seen, plan participants say they know more about investing in their company's stock than any other investment option. They also mistakenly say company stock is less risky than a diversified domestic equity portfolio. Is this what your employees think?

Senator, again, we don't test our employees' knowledge of how to use the retirement plan. We keep track of how many creativity awards our retirement education provider has won, how many employees are participating compared with other companies and things like that.

In your retirement plan booklet, you say the plan is intended to help individuals achieve their personal retirement dreams. Yet today you're saying you don't measure how well individual employees are doing in defining, pursuing, or achieving their personal retirement dreams? So how do you know if your plan is achieving its strategy?

I didn't think I was going to be asked about retirement adequacy for employees.

We've seen surveys showing that most 401(k) plan sponsors don't believe that even half of their plan participants will be able to afford an adequate retirement. Given that acknowledged 50% failure rate, do you really think 401(k) plans are working well as retirement plans?

You know, this hearing isn't at all what I thought it was going to be.

Ms Smith, you've stated that employee education is a critical element in helping employees be successful in using 401(k) plans.

Yes, of course it is.

If it's that important, then I'm sure you have a clearly written policy statement that guides your retirement education and communication activities. Can you tell us about the specific goals and measures you have for your retirement education program? Are those measures based on what successful participants know and do?

We probably should have that kind of policy statement, but ….

Ms Smith, are all the education and communication issues we've discussed today things you've known about for several years?

Certainly, all plan sponsors know these things. Wait, my attorney says I need to retract that answer.

So you've had several years to fix your education program and you've chosen not to.

My attorney says I don't have to answer that.

Would you say that all your actions in retirement education – as well as actions you've chosen not to take – were in the best interest of participants?

I can't answer that.

Ms Smith, I don't want anyone to think that what you did or didn't do in retirement education was illegal or that you intentionally did anything to hurt your employees. But I do wonder if you would agree that most 401(k) plan sponsors need to completely reevaluate the goals, techniques, and measures they have for retirement education? Because without knowledgeable employees, how can voluntary, employee-directed retirement plans work well? Oh never mind … that's another question your attorney won't let you answer.

Thank you for your testimony of how well run defined contribution plans provide retirement and investment education for employees.

Wake up. It's just a dream. Isn't it? Or maybe the Enron mess was a wakeup call.

If employee-directed retirement plans are to provide employees with adequate retirement income, it's essential that the plans be accompanied with an effective retirement education. And the providers of retirement education need to have specific measures to ensure individual participants are acquiring the knowledge they need to:

- price their personal retirement income target,
- contribute and invest to attain that target, and
- receive their income so it lasts throughout retirement.

Without education outcome measures, how will plan sponsors know if they are achieving the plans' strategy – helping employees define and achieve their personal retirement dreams?

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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**.