

The Massive Failure of 401k Education

By Dennis Ackley

Lots of hard work and great intentions have gone into the retirement aspects of personal financial education.

Yet sadly, 401k education is the largest failure ever of adult education.

What's the failure look like?

At *best*, \$400 a month.

That's the expected lifetime income when all 401k and IRA accounts are combined in typical households headed by employees age 55-64⁽¹⁾. The median total balance in those households is \$120,000. Using the 4% a year lifetime withdrawal guideline many financial planners follow⁽²⁾, it's \$400 a month. (\$120,000 × 4% ÷ 12 months).

Looking at 401k accounts alone, it's around \$200 a month for life for typical employees age 55-64 (using the 4% guideline). Their median 401k balance is about \$62,000.⁽³⁾

Most of the content and techniques used in today's 401k education came from 1980s mutual fund sales materials and presentations. They were designed for financially aware people who were interested in mutual funds to supplement their traditional pension plans. Does that sound like today's typical company employee?

There was no sinister motive. It was just easy and inexpensive for the mutual fund industry to change the name of the sales materials to "401k education." But it was:

- Not pilot tested,
- Not modeled after successful voluntary retirement education programs,
- Not designed using adult-education principles,
- Not based on competencies employees need to begin using 401ks successfully, and
- Not equipped with success testing tools.

In 30 years, about the only change is now some content is delivered via websites, emails and Twitter.

Test it yourself. Ask 401k education providers, "What specific skills and knowledge must

beginning 401k users have to be successful? And how do you measure the results of your education to ensure employees know what to do and how to do it?"

Unfortunately, many providers don't have the answers. So how can they determine what should be in or out of a basic 401k education curriculum? Or how do they prove to plan sponsors that the instruction they are doing is effective?

After 30 years and millions of "students", if the current approach to 401k education was going to help employees accumulate enough money for a decent retirement, shouldn't it have done it by now?

No well-run organization would allow drill-press trainers to teach new operators without a clear description of the required competencies and without success measures. Why is that allowed in educating new 401k operators?

Cruellest Consequence

Ask some employees how much money they would need in an account to afford the retirement they want. Most will have no idea. Yet, it will be the most expensive "purchase" most people will ever want to make. (We were told it was a house – we were told wrong.)

Research shows only four in ten employees say they've tried to calculate how much they'll need in retirement. Even about half the workers age 50-65 don't know.⁽⁴⁾ This is tantamount to intending to start a new career and having no idea how much it will pay or where the money will come from.

Why is the realistic cost of retirement a mystery? It could be because the 1980s mutual fund presentations didn't address it, so it's still not covered in 401k education?

The Massive Failure of 401k Education

The retirement industry has had an odd practice of “benchmarking” retirement plan *features* – not plan *outcomes*. Today, fewer than 5% of plan sponsors focus on retirement income as a success measure of their 401k retirement plans.⁽⁵⁾ If retirement income is not the main purpose of a retirement plan, what is?

No Target, No Success

Every beginning 401k user needs a personally meaningful, realistic target account balance. Research shows that employees who know how much they need are not discouraged. In fact, they save more.⁽⁶⁾

It’s illogical to expect employees to reach a target that is unknown to them or they have not personally set...especially one that requires substantial financial contributions.

Here’s a simple approach. Imagine you’re age 65 today and it’s your last day of full-time work. You have \$100,000 and you expect to spend it over 25 years to 90. And say you’ve put it in bank CDs (a favorite of retirees), and the CD and inflation rates are the same. If you divide \$100,000 by 25 years, how much is that each year?

Is it really only about \$4,000 worth of buying power a year – \$333 a month – before the account runs out?

Is this realistic? Is it meaningful?

Coincidentally, this example reinforces the 4% guideline that a \$100,000 account provides around \$4,000 in buying power a year.

Questions Fuel Motivation to Learn

Most 401k education delivery is based on the old sales presentation model of having an expert **tell** employees what to do.

But for people who are not yet motivated to learn about retirement – most young adults – telling isn’t teaching

Clay Christensen, a widely admired Harvard professor, paints a vivid image of how adults learn. “Questions are places in your mind where

answers fit. If you haven’t asked the question, the answer has nowhere to go. You have to want to know the answer.”

Telling unmotivated adults to save and giving them advice they haven’t sought are wasted efforts.⁽⁷⁾

Rather than tell employees what to do, an effective 401k education program should help them imagine their future lives and dreams. The curriculum could be designed to get employees to ask themselves, “On top of income from Social Security, personal assets and part-time work, how many \$100,000 accounts would I need to support the retirement lifestyle I want?”

Shouldn’t employees discover in their 20s – and not in their 60s – that every \$1,000 a month will take around **three** \$100,000 accounts? Not knowing the cost from the start of their careers steals the time they need to accumulate the account balances they’ll want.

Helping young employees discover a realistic idea of the cost is just the start. It’s intended to turn them into motivated learners who will want to learn much more about retirement and obtain sophisticated advice from financial professionals.

Starting early and making substantial contributions are essential for success using 401ks. Unfortunately, getting a good start early in their careers is something most employees do not get.

Nudging to Success

Some prominent behavioral economists have a well-intended theory of nudging employees through automatic enrollment and escalating contributions so employees will accumulate several hundred thousand dollars for retirement. That’s fine as long as it’s done along with education so employees know, among other things, the realistic cost of the retirement they want.

To believe automatic provisions will work without effective education, you must also believe that employees will never take the 401k money out

when they change jobs, buy a house or encounter a hardship – and they will never reduce their contribution rate – even though they have no idea how much the retirement they'll want will cost. What are the chances of all that happening?

If organizations want employees to be successful using voluntary retirement plans – 401ks, 457s and 403bs – they must make sure employees know how to use the plans to provide the retirement income they want.

American workers deserve retirement education that leads them to discover how to use voluntary retirement plans successfully...or retirement plans that don't require knowledgeable users.

End Notes

1. 2010 Survey of Consumer Finances, Federal Reserve System, June 2012.
2. Revisiting the '4% Spending Rule', The Vanguard Group, August 2012.
3. How America Saves 2012, The Vanguard Group, June 2012.
4. Financial Literacy and Retirement Planning in the United States, Lusardi and Mitchell, February 2011, Netspar.
5. Looking Into the Stars, Plansponsor Magazine, November 2012.
6. The 2011 Retirement Confidence Survey, ebri.org, Issue Brief, March 2011.
7. Asking for Help: Survey and Experimental Evidence of Financial Advice and Behavior Change, Hung and Yoong, RAND Corporation, January 2010.

Dennis Ackley

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. Early in his career, Dennis spent six years in educational research and instructional design. For the next 30 years, he worked in retirement administration and communication consulting. More of his ideas regarding retirement education can be found at www.DennisAckley.com.

A version of this article appeared in the Second Quarter 2013 issue of **The Standard** – a publication of the Association for Financial Counseling and Planning Education.

© Copyright 2013 Dennis Ackley

*If you did not download this from
www.DennisAckley.com,
it's not a legal copy.*