# Your 401(k)—a Lifeline to Life After Retirement

***As defined contribution plans become the norm, employers are looking for ways to increase employee participation.*** **By Denise Doig**

As employers move away from defined-benefit (DB) plans into the defined-contribution (DC) arena, issues such as employee participation keep reappearing. Even as financial analysts continue to predict the dissolution of Social Security benefits, many U.S. workers still have not heeded warnings. These are no longer the good ol' days of pension plans and employer-sponsored retirement packages; employees must find new ways of investing to generate a healthy retirement income in their latter years.

There is one main difference between DC and DB plans: who pays. Traditionally, employer-sponsored or DB plans require no contribution from employees. A specific amount is set aside each pay period for the employee's retirement. These plans are normally based on years of service and/or salary. The employee is fully aware of the expected amount of retirement funds he or she will have upon leaving the company.

But in recent months, many of the *Fortune* 500 have frozen DB plans and are in the process of getting rid of them, mainly due to the cost it takes to keep them afloat. Funding for these plans normally comes from company profits.

In contrast, DC plans require the employee to fund all or some of the plan out of pocket. While the amount contributed is fixed, the return is not, and the employee won't know the worth of the plan until it is cashed out. Some well-known examples of DC plans include 401(k), 403(b), Roth 401(k), and stock-ownership plans.

With more companies offering DC plans, employers are interested in increasing employee participation, but many don't know how. According to Mark Scalera, CEO of Providence Benefits Group, 60 percent of organizations sponsor 401(k) plans, which is up from 10 percent only a few years ago. The decline in DB plans has driven more employers to offer 401(k)s.

Approximately 440,000 companies sponsor 401(k) plans, with a large portion representing small businesses. David Wray, president of the Profit Sharing/401(k) Council of America (PSCA), said there has been major growth in the smaller market. He added that employee participation is estimated at 70 percent presently.

However, according to a recent study, "401(k) Plans Are Still Coming Up Short," conducted by the Center for Retirement Research (CRR) at Boston College, these figures are misleading. Although the numbers show more people participating, there has been a decline in the number of workers who are actually eligible to participate in 401(k) plans. Not surprisingly, younger workers are the least likely group to enroll in these retirement savings programs. But as a retirement option, the benefits of 401(k) plans cannot be denied—pre-tax contributions, tax-deferred growth, diversification, and the ability to roll over. So why aren't all employees taking advantage of 401(k)s?

Advisors suggest a number of ways to increase participation. Here's one: take a survey of all of your employees. Ask them if they are enrolled in your 401k plan; why or why not? Chances are you may be surprised by their answers. Many times the problem lies within the employer and not the employee. Employers do not provide enough financial education about plans. Often HR distributes a booklet on the program and a contribution sheet for the employee to fill out.

According to Tony Tortorella, vice president of sales, Human Resource Services at Paychex, misinformation about 401(k) allocation is very prevalent. Some employees mistakenly believe that they can't afford to participate in their company's 401(k) program. However they are doing themselves a disservice in the long run by not participating. With accounting scandals such as Enron

still fresh in their minds, workers are afraid the money they invest will be lost, he said.

"Using a money market to invest your funds poses virtually no investment risk," explains Tortorella.

Often, employees are also reluctant to invest if they believe that they won't remain at a company for long for fear of leaving their money behind. Many don't realize that money invested in a 401(k), matched by the employer, or a combination of the two is the employee's assets not the employers. Some are unaware that they have the option to keep the account open or roll the funds over to another 401(k) or IRA. According to Scalera, funds can also be rolled over into an IRA by forced distribution if there is less than $5,000 in the terminated employee's account in the previous year. Unfortunately many workers don't roll over, or if they do they no longer manage the account properly. Some even cash out regardless of the 10 percent tax penalty they have to pay. According to the CRR study, in 2004 45 percent cashed out, and the majority of them were younger workers. The study also reported that the majority of 401(k) participants fail to diversify their portfolios, potentially limiting their retirement income.

Employers are recognizing that many employees are not capable of managing an account on their own. Companies are introducing improved resources for their employees to combat these issues Thanks to the Department of Labor (DOL), 401(k) management is undergoing a transformation. The DOL has recommended financial advice be made available to all employees.

Some companies are bringing in individuals from fund sponsors to educate employees; other options include access to online information about the funds, the distribution of detailed printed material, and customer support centers.

"It is an ongoing process to re-educate employees on a yearly basis on principles such as asset allocation and diversification," Scalera stated.

Another alternative is to partner with financial institutions to provide advice. "In our case, we team with Merrill Lynch, Smith Barney, and Edward Jones to have a financial representative assigned to each participant," Tortorella described of Paychex's approach. "We have also just introduced individual participant financial advice and managed accounts through an independent firm called Guided Choice."

He added that communication between employers and employees is paramount to a successful 401(k) plan. With informational sessions and mandatory open enrollment meetings, the employer can reach out to alienated employees.

Another issue is the younger employee. Many recent graduates do not take retirement savings seriously. They make the assumption that retirement savings is something you do when you're older. This is a grave mistake. According to retirement services provider Transamerica Retirement Services, the earlier you start saving for retirement, the more you will have when you are ready to retire. It has been predicted that Social Security will either become obsolete due to economic deficits or become privatized; whatever happens, employees cannot rely on social security alone. On average, retirees are receiving approximately $12,000 in social security benefits a year, but that does not cover even half of what is needed to live comfortably as a retiree. Some planners predict that workers will need to save enough to draw at least 80 percent of their current salary each year to properly plan for retirement.

To combat the apathy of the younger worker, a popular but controversial solution is automatic enrollment, sometimes referred to as passive enrollment. Upon hiring a new employee, the employer will defer a percentage of the employee's salary for the 401(k) plan. A default salary deferral percentage is established for automatic enrollment, which is usually between 3 and 4 percent. Employees have the option to sign a waiver to prevent deferrals and change the default contribution.

Some critics believe automatic enrollment doesn't take enough investment risks. However, because employees should start saving as soon as possible, automatic enrollment allows immediate saving opportunities. And some companies are even offering plans with increased default contribution rates to help employees save more.

"A company can only offer a salary deferral match or a profit-sharing contribution as ways to increase the amount of money that accumulates in an employee's retirement account," Tortorella said. "Matching is done in nearly 90 percent of the plans we sell in a year."

However, Scalera said he believes the employer matching rate has hit its peak. "There has been a leveling off of matching. Discretionary matching contributions are more common now, which ties the employer's contribution to the company's profitability. This gives the employee an incentive to participate in the employer's ability to contribute more to the 401(k) plan."

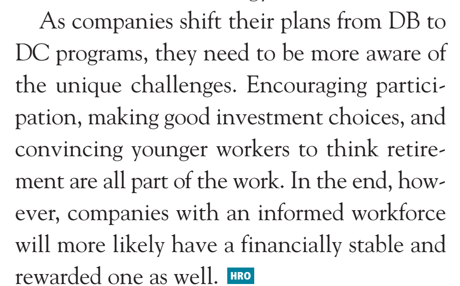
Scalera added that employers should poll their workers to find out what they want from the 40l(k) plan—a popular answer may be loan provisions. He also stated that offering the Roth 401(k) may be a good option to meet the needs of younger employees.

"The Roth 401(k) feature and independent, individual investment advice are two of the most sought-after features in the market today," Tortorella added. "If recordkeepers don't provide access to either of these, I would say that the 401(k) plan would be outdated within five years."

Outsourcing is another option for employers. Data management and financial management are two areas ripe for outsourcing, according to Tortorella. Good financial management gives employees accessibility to professionals who can answer questions about 401(k) investing and provide advice on managing their retirement savings. A data manager will handle daily changes affecting the plan—from deferral amounts to loan calculations and repayments. An external data manager handles employer matches, profit-sharing amounts, payroll deductions, recordkeeping, and even online information.

"An outsourcer is necessary because no company has the time or systems to easily facilitate this very complicated, yet vital employee benefit." Tortorella added.

For employers, the bottom line is when looking for a provider to manage the 401(k) plan, look for one that's strong fund selection, education, and technology.



As companies shift their plans from DB to DC programs, they need to be more aware of the unique challenges. Encouraging participation, making good investment choices, and convincing younger workers to think retirement are all part of the work. In the end, however, companies with an informed workforce will more likely have a financially stable and rewarded one as well. HRO