

As 401(k) plans evolve, participation will become more automated

401(k) ADVISER
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Corporate retirement plans seem to be in a constant state of change.

Corporate retirement plans were simple once. You got hired, worked hard, retired, and then sat back and collected a monthly check for the rest of your life.

This type of retirement plan, known as a pension plan, was once the norm in corporate America. Today, less than 20% of the private sector work force is covered by such a plan. The reason: Most companies can no longer afford to offer one.

Partly because of runaway pension costs, the 401(k) plan was created in the early 1980s and radically changed retirement benefits in corporate America. 401(k) plans reduced company costs and gave employees much more control in determining their retirement income. They also gave employees more freedom to switch jobs and take their retirement program with them.

Over the past 25 years, the 401(k) plan has become the dominant type of retirement plan in the United States.

Growing concerns about the under use of 401(k) plans, the stability of Social Security and growing life expectancies have created momentum for more change in retirement plan design.

The primary push is to change 401(k) plans to operate more like pension plans by automating most of the decisions that employees are required to make. No more forcing employees to answer difficult questions such as: How much should I save? Should my savings be pretax or after tax? Where should I invest?

Instead, 401(k) plans of the future will automatically enroll all employees. Companies will determine not only their own matching contribution rate but also employees' initial deferral rate, investment strategy, and the pretax or post-tax nature of employee contributions.

These decisions will be automatically made for employees based on their date of birth, income, and well-established financial planning and investment principles. Over the years, employee contribution rates will be automatically increased in sync with their pay increases to minimize the effect of higher savings on their take-home pay.

Of course, employees who choose to will be allowed to opt out of the pre-set program and make their own decisions.

Closing the gap

Employees' quarterly 401(k) statements will also change.

In the future, they will not only report asset accumulation, but will also include a quarterly analysis of employee progress toward achieving their retirement income goal.

I call this a quarterly "gap analysis" because it will show the gap between how much they have saved and where they should be, based on a predetermined retirement income replacement formula.

If the analysis indicates the employee is ahead of schedule, he might consider saving less, investing more conservatively or retiring early. If the analysis indicates he is behind schedule, the employee will be advised to consider saving more, investing more aggressively or working longer.

At retirement, employees will be able to fill out a short form that describes when they want their monthly retirement income to start.

Companies will establish an online marketplace to negotiate with competing insurance companies on the employee's behalf. The employee who doesn't want to manage his or her own money in retirement simply selects the most attractive offer from several highly rated insurance companies, clicks a button, and the 401(k) account is converted into a lifetime stream of monthly income.

Sound farfetched? Every single one of these 401(k) plan features of the future exists today and is being enjoyed by employees somewhere.

Changes take time

But change is always difficult, and it will undoubtedly be some time before these new automatic 401(k) plan features gain wide acceptance. Heck, some companies still refuse to provide 401(k) participants with a daily valuation of their account.

However, because there is compelling evidence that these features improve participation, increase deferral percentages, accelerate investment results and lower costs, I predict they eventually will become the norm.

Because companies cannot afford to contribute as much as they once did to corporate retirement plans and still compete in a global marketplace, they must work hard to find creative ways to help employees maximize their retirement benefits. Making 401(k) plans more automatic is the next step.

In the end, we will have come full circle - a retirement plan that is simple and maximizes the chances that employees will be able to sit back, collect a monthly check, and enjoy a comfortable retirement.

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