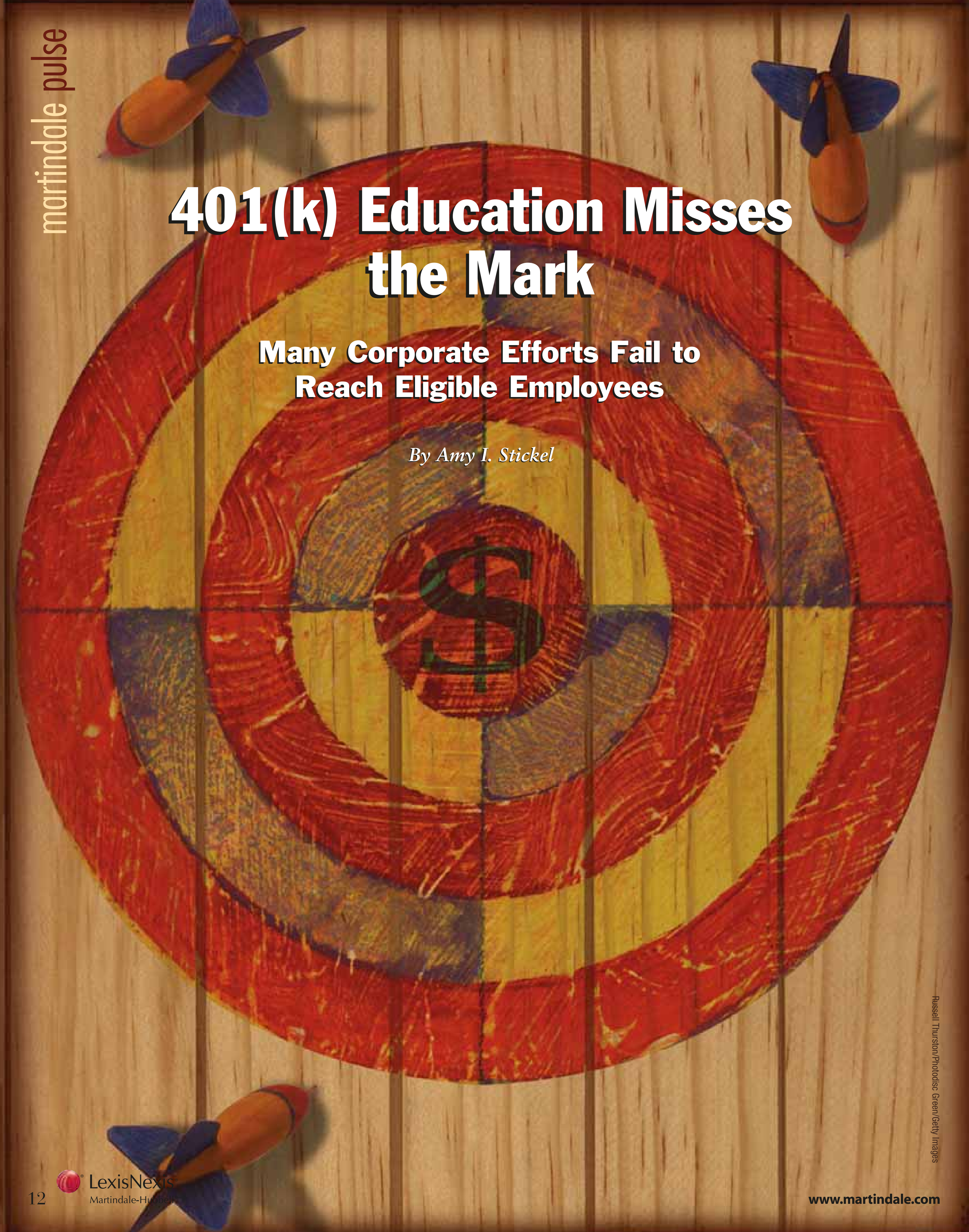


401(k) Education Misses the Mark

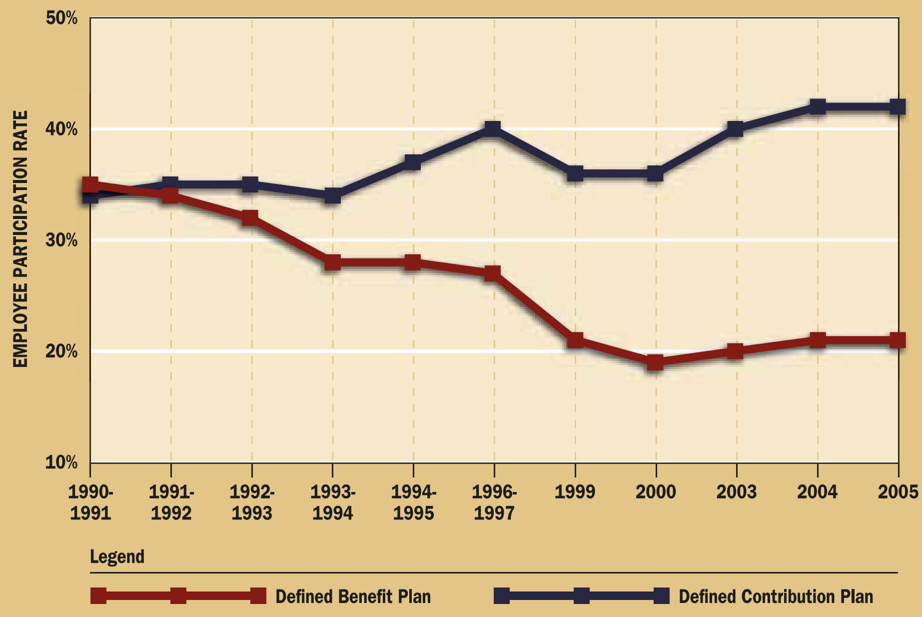
Many Corporate Efforts Fail to Reach Eligible Employees

By Amy I. Stickel

Russell Thurston/Photodisc Green/Getty Images

Fewer Pensions, More 401(k)s

The percentage of employees participating in pension plans has slid as fewer employers offer them, while defined contribution plans such as 401(k)s have grown more popular.
Note: Data was not collected or not tabulated in omitted years.



Source: Bureau of Labor Statistics

Since about three-quarters of eligible U.S. employees participate in 401(k) programs, isn't it fair to say that the 401(k) is a success? While many companies may not have traditional pensions anymore, most 401(k) plans offer numerous investment options, generous company matches and a wealth of educational materials.

Unfortunately, according to many experts, extensive mutual fund options, glossy brochures with lots of pie charts and a 70 percent-plus participation rate are not nearly enough to help most workers—particularly lower-income workers—retire in a relatively comfortable manner. For companies, keeping workers on the payroll who are in their 60s but can't afford to retire can create a legal problem, as well as an ethical one.

"With 401(k)s, there are unsophisticated, unprepared people making fairly complicated decisions," says Jodi DiCenzo, a behavioral research consultant who works with companies to explore why workers make the financial and retirement decisions that they do. "There are resources out there that show what we are doing isn't working."

David Certner, director of legislative policy with AARP, agrees. "There are a lot of opportunities to screw up with a 401(k)," he says.

From Passive Pensions to Active 401(k)s

The concern over funding retirement has grown as guaranteed pensions have become less common and 401(k) plans have become more popular. In 1990-1991, there were nearly as many private-sector workers participating in defined contribution plans, including 401(k)s, as in pension plans; by 2005, there were twice as many workers in those plans as those with pensions (see *Fewer Pensions, More 401(k)s*).

The move away from defined benefit plans such as pensions to defined contribution plans such as 401(k)s has been a paradigm shift for employees and employers alike, according to John G. Ferreira, a partner in the employee benefits and executive compensation practice at Morgan, Lewis & Bockius LLP, Pittsburgh. "Defined benefit plans were very passive; there was no burden on the employee to do anything but work," says Ferreira. "Defined contribution plans offer a set of tools, but if employees don't use those correctly or wisely, they will fall short of their retirement goals."

Companies must make sure that employees have the tools they need to make appropriate investment decisions, Ferreira stresses. If employees find themselves without the money to retire, they may have to keep working. "They will be hanging around after they would have moved on, and may feel disgruntled toward their employer, whether that is legally valid or not," he says.

Fear of future litigation is one reason to develop an education program, even though there are no strict legal requirements that companies do so, says Ferreira. He points to a recent case his firm was involved with, *DiFelice v. US Airways, Inc.* In that case, which was decided in June, plaintiffs argued that US Airways breached its fiduciary duty by allowing company stock to remain as an investment option in the 401(k) up to the time the company filed for bankruptcy.

When deciding for Morgan Lewis' client, US Airways, Judge T.S. Ellis III found that since US Airways had provided education about investment options, the "fiduciary should not be deemed to have violated any fiduciary duty for offering this option provided the investment in company stock remains viable, and the company has fully disclosed to participants the risks attendant in that investment."

This case proves that education is valuable, both for employees trying to invest wisely and for employers who may face a lawsuit. "The company clearly and effectively communicated the risks," says Ferreira.

Ferreira also suggests targeted communications, rather than less specific brochures and mailings. Rather than sending out a generic brochure about different funds and options, plan providers can tailor information to specific employees that takes into account criteria such as age and how close employees are to retirement. "For example, a targeted communication can be sent to an employee that says, 'You, John, have invested all your money in company stock, and here's why you may want to rethink that,'" he suggests.

Finding the Benchmark

DiCenzo agrees that companies must do some educating of their employees, but they could and should do more than that. "A certain amount of education is necessary, but it doesn't impact people's behavior," she says. "I think it's imprudent to spend millions of dollars of company or investment assets on education."

Companies should stop considering most external benchmarks, such as education and enrollment rates, as the appropriate measure for an adequate defined contribution plan—rather, the benchmark should focus on how many employees are saving enough to enjoy a life after their working years, she says. For

Considering Your Options

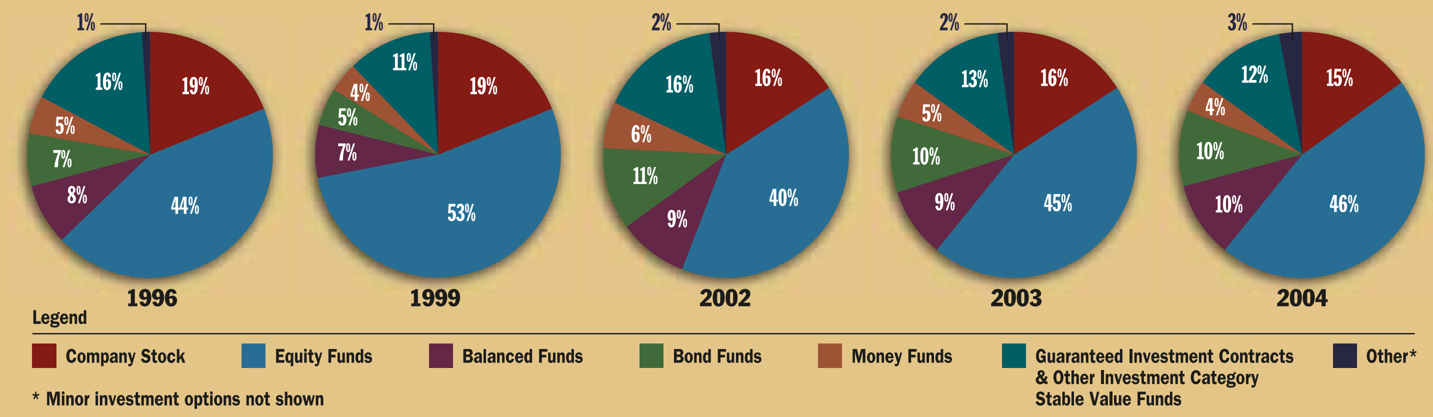
Company stock as an investment option in 401(k)s may have gotten a bad rap from Enron and other companies that tanked, when employees both lost their jobs and saw the value of their retirement savings plummet.

Nonetheless, there are still valid reasons for including company stock as an investment option, says John G. Ferreira, a partner in the employee benefits and executive compensation practice at Morgan, Lewis & Bockius LLP, Pittsburgh. "Employees like the feeling of owning company stock, and it aligns the interests of the company and the employees," he says. "Philosophically, it can be a very positive thing, but it has to be done well and it has to be done right."

Encouraging participants to diversify their portfolios, limiting the percentage of 401(k) savings that can be held in company stock and ensuring that an independent financial adviser, rather than top executives, oversees the defined contribution plan can all limit liability, says Ferreira.

Taking Stock of Company Shares in a Portfolio

The percentage of company stock as part of a 401(k) allocation has fallen slightly since 1996.



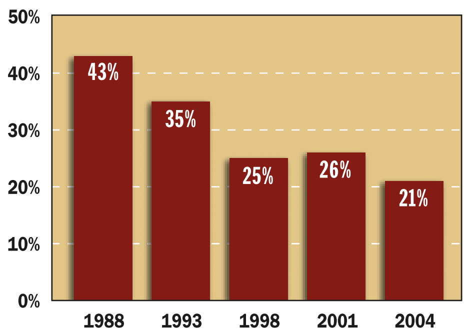
* Minor investment options not shown

Source: Employee Benefit Research Institute

Signing Up

Since the late '80s, the number of eligible employees who decline participation in their company's 401(k) plan has fallen markedly, down to 21% in 2004.

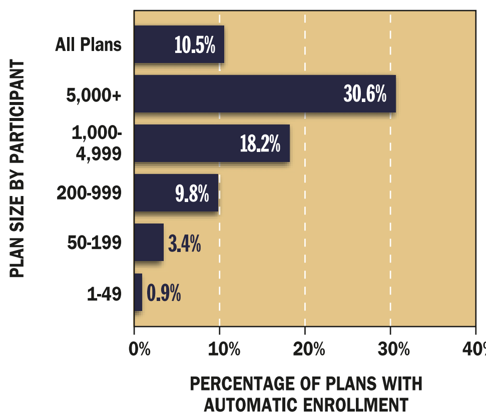
Percentage of Eligible Workers Not Participating in 401(k)s



Source: Center for Retirement Research at Boston College

On Auto Pilot

Large employers in particular are taking the initiative and enrolling employees in 401(k) plans automatically, when employees fail to sign up on their own.



Source: Center for Retirement Research at Boston College

example, in 2004, 21 percent of eligible employees were not participating in their company's 401(k) plans, changed from 43 percent in 1988 (see *Signing Up*). That may seem like a promising trend, but that's not enough to allow employers to pat themselves on the back, she warns. "Your benchmark should be what people need to retire comfortably," DiCenzo says.

The Automatic Plan

The difficulties in educating reluctant employees and encouraging them to enroll are convincing many organizations to try a different approach. "Automatic enrollment plans are picking up," says Certner of AARP. In a typical automatic enrollment plan, a certain percentage of an employee's pay is automatically deducted and put into a 401(k), unless the employee specifically opts out (see *On Auto Pilot*). Such plans can be particularly effective in reaching lower-income workers who are less likely to participate in a 401(k) plan otherwise.

Many of these plans also include an automatic escalation feature; as employees get older or receive pay increases, the percentage of money contributed to the 401(k) rises as well.

Of course, someone still must choose an investment vehicle for those in automatic enrollment plans, and this is where it gets complicated for employers, says Ferreira. "Companies that have shed their defined benefit plans don't want to go back to that world," he says. "We're creeping closer to making decisions for employees."

DiCenzo advises in-house counsel to recognize that they and their clients have a pervasive impact on the retirement security of their employees. "Plan design—how the company structures the plan provision and services—plays a significant part in determining whether many employees will be able to retire," she says.

But the old cliché is true, according to DiCenzo. By not making a decision, employees and plan sponsors are still making a decision.