

Making 401(k) Plans a Win-Win Proposition: Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

401(k) plan fiduciaries and providers may face countless lawsuits in the future as participants realize that their 401(k) accounts are not large enough to provide them with the retirement lifestyle they have anticipated. Plan sponsors, plan fiduciaries, and service providers themselves will be the cause of many of these lawsuits because they have not presented to employees a realistic picture of what it takes to achieve the retirement lifestyle of their dreams. This paper discusses the actions that should be taken to minimize the risk of such lawsuits and also help participants achieve financial security.

Author

Richard D. Glass

Published in

Benefits and Compensation Digest

February 2005

International Foundation of
Employee Benefits

For more articles by Investment Horizons personnel, please visit our website at:

www.investmenthorizons.com/papers.htm

Making 401(k) Plans a Win-Win Proposition: Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

Richard D. Glass

“The greatest problem with communication is the assumption that it has taken place.”

—George Bernard Shaw

“Should 401(k) plans be the primary retirement vehicle for the typical American employee?” is a question that is now being seriously addressed.¹ This question highlights the stark contrast in attitudes of both providers and sponsors between the 1990s and today. In the 1990s, 401(k) plans were portrayed as being the best thing after apple pie and motherhood. Since the stock market performance of that decade was spectacular, participants, indoctrinated with the investment mantra “stocks for the long run”², readily bought into that story.

There are many factors that have led to the reexamination of 401(k) plans. These include the extensive (and apparently never-ending) press coverage of the scandals that have permeated Wall Street and the mutual fund industry^{3,4}, the significant increase in global competition, and fundamental structural changes in the industrial landscape (downsizing, outsourcing, and exporting jobs and production overseas).

Two other important stimuli in getting fiduciaries to rethink their responsibilities to 401(k) participants were the dot-com bust and the collapse of Enron. The stock market collapse (resulting in participants watching their account balances plummet) reminded many fiduciaries why their corporations terminated their defined benefit pension plans—namely, unpredictable funding requirements triggered by volatility in the value of plan investments.

The Enron debacle and resulting lawsuits focused attention on, among other important issues, which members of the management team could be construed as plan fiduciaries (besides the named ones) and what their responsibilities are.

Another ingredient that should be added to the cauldron is that a significant portion, perhaps the majority, of participants are investing blindly⁵ since they know very little about retirement planning and basic investing⁶. The likely outcome of blind investing is totally inadequate retirement nest eggs⁷.

¹ William Wolman and Anne Colamosca, *The Great 401(k) Hoax: Why Your Family's Financial Security Is At Risk, And What You Can Do About It*, Perseus Publishing, 2002.

² Jeremy J. Siegel, *Stocks for the Long Run: The Definitive Guide to Financial Market Returns and Long-Term Investment Strategies*, McGraw-Hill, 2002.

³ Eugene N. White, “Foxes in the Coop: Conflicts of Interest in Mutual Funds”, *The Milken Institute Review*, Third Quarter 2004, p. 45.

⁴ Peter Elkind, “The Untold Tale of the Great Mutual Fund Ripoff”, *Fortune*, April 26, 2004, p.106.

⁵ According to EBRI's *2003 Retirement Confidence Survey*, only 37% of American workers have calculated how much money they will need to have saved by the time they retire. One-third of those those who did the calculations did them within the last twelve months.

⁶ Over the last decade, The John Hancock has sponsored a series of surveys (*Defined Contribution Survey of Insight into Participant Knowledge & Behavior*) that has unfortunately demonstrated that participant understanding of investment principles has remained unchanged.

⁷ Jack VanDerHei and Craig Copeland, “Can America Afford Tomorrow's Retirees: Results from the EBRI-ERF Retirement Projection Security Model”, November 2003.

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

Thus, these participants may be forced to conclude that lawsuits against plan sponsors, inside fiduciaries, and outside service providers are the only possible way for them to achieve retirement security.

It is also easy to argue that plan sponsors, fiduciaries, and providers, in order to maintain employee goodwill, have not presented participants with a realistic picture of what is involved in obtaining their retirement goals. Simply put, participants have not been told that retirement planning is not easy and that achieving retirement security takes time, luck, adequate contributions, and the participant's own active involvement⁸.

In this paper, the author lays out steps plan sponsors and providers can take to minimize the likelihood of successful lawsuits against them for breach of fiduciary responsibility while simultaneously helping participants achieve retirement security.

What can plan fiduciaries and providers do to make participants and eligible non-participants understand their responsibilities?

Perhaps the two most basic obligations of 401(k) plan fiduciaries are to notify employees that:

- achieving their desired retirement lifestyle is their responsibility; and
- to accomplish this goal, they must use their 401(k) plan wisely.

Unfortunately, few fiduciaries or providers fulfill these crucial responsibilities in a forceful enough fashion.

Of course these issues get addressed. In particular, plan sponsors generally understand that one of the pre-requisites for obtaining "404(c) protection" for their participant directed 401(k) plan is that they tell participants that making proper investment choices is solely their responsibility. The problem is that sponsors and providers generally say little more than that, and that message is generally buried within layers of "happy talk" about how wonderful the plan is and how many great features it contains. Too many enrollment meetings leave participants with the impression that all they have to do is join the plan and make some arbitrary contribution—then, the employer will make a matching contribution and retirement security will be all but guaranteed. Participants are not clearly informed that, unless they use the 401(k) plan wisely and that the stock and bond markets "cooperate" (i.e., actual returns reflect the assumptions used), they are simply fooling themselves.

No one bluntly tells employees that they can borrow to fund a child's education, but they cannot borrow to fund their retirement. Seldom are non-participants asked to sign a statement saying that they have analyzed their priorities and needs and not participating in the 401(k) plans was an informed decision. Rarely, if ever, do fiduciaries send eligible non-participants personalized reports showing why joining the 401(k) plan and using it wisely are two of the smartest steps they can take if they wish to achieve financial independence. Fiduciaries also rarely send participants who are contributing at a low level, and/or whose investments are overly conservative, personalized reports projecting their future savings and illustrating the gap between those projected savings and what they'll actually need in the future to achieve their retirement goals.

This behavior is not surprising given the current climate of downsizing, outsourcing, exporting jobs overseas, and giving new hires fewer benefits than what current employees receive. Sponsors do not

⁸ The stark realities confronting American society with regard to retirement is summarized in David Wessel, "Keeping Pension Promises Poses Challenge", *Wall Street Journal*, September 16, 2004, A2.

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

want to do anything that might worsen employee relations even further. Telling employees that, in order to retire comfortably (an event which may be many years away), they must significantly reduce their take home pay today is an action often viewed as an unwise, if not a downright stupid, human relations move.

Unfortunately, inside plan fiduciaries may be confusing two issues: fulfilling their fiduciary responsibilities to the participants and their roles as corporate executives. Court decisions⁹ have affirmed that there must be a Chinese wall between the two roles. In addition, ERISA clearly states that fiduciaries have a duty to protect participants from misleading information.¹⁰ What this means is that inside fiduciaries must ignore any concerns about morale or “public relations” issues and give plan participants the truth, the whole truth, and nothing but the truth.

In point of fact, ignoring these fiduciary responsibilities to participants does not serve the employer’s best long-term interests. After all, having a workforce that cannot afford to retire, that is difficult to fire due to the Age Discrimination in Employment Act (ADEA), and that does not want to be working is detrimental to any company’s profitability—and may even threaten the company’s survival. Moreover, this situation will generate a myriad of lawsuits in which the fiduciaries may be held personally liable. Even if fiduciaries aren’t judged as having breached their responsibilities under ERISA, such suits will be expensive to defend, time consuming, and emotionally draining.

There is simply no excuse for not telling participants the truth in a candid fashion. 401(k) plans should be presented as what they are: a tool that employees can use to help themselves and not as a wonder drug that solves their retirement problems, presumably, just by swallowing (participating in) it.

A simple gap analysis, personalized for each participant (Figure 1), would go a long way toward fulfilling these fiduciary responsibilities. The report would be accompanied by a letter from the plan sponsor stating that the purpose of the report is to show each participant a suggested contribution that would put them on the road to realistically achieving their retirement goals (assuming all the underlying assumptions—which are clearly disclosed on the report—materialize). The letter and the report would also remind the participant that:

- achieving retirement security is their responsibility;
- the participant’s other assets (if any) have not been factored into the calculations;
- reality and assumptions often do not jibe;
- they must periodically reevaluate (through calculators on the provider’s website or with the help of a financial advisor) the adequacy of their contributions.

“Why you should be investing in the 401(k) plan today!” (Figure 2) makes clear to each eligible non-participant the advantages of investing through the 401(k) plan. Like the gap analysis report, it should be accompanied by a letter from the sponsor stating that the employee will be declining a valuable opportunity by not participating in the plan. The letter should also state that the hypothetical outcomes shown by contributing the suggested amount are not guaranteed since realized and assumed growth rates can be (and often are) quite different.

⁹ Many of these court decisions are summarized in the Department of Labor’s amended brief as amicus curiae opposing the motions to dismiss many of the lawsuits for breach of fiduciary liability against Enron and its employees (Civil Acton No. H-01-3913 and consolidated cases).

¹⁰ Ibid., p. 17.

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

“Is it a fiduciary responsibility to provide investment education to 401(k) participants?” is the wrong question to ask.

Many corporate executives find it difficult to believe that they have a duty as a fiduciary to tell employees that they, and not their employer, are responsible for their own retirement security. After all, Americans are an independent group. Common sense dictates that they should understand this responsibility. Furthermore, employees (should) know that their provider has calculators on its website which they can use to see how much progress they have made toward their retirement goals. If employees do not want to use these calculators—or any of the multitude that are available free on the Internet—they can always hire an advisor to help them.

What participants should know and do obfuscates the real issues facing fiduciaries. ERISA requires fiduciaries to act in the best interest of participants. Unfortunately for fiduciaries, the courts have not decided what this means.

However, acting in the best interest of participants—whatever that means—requires knowing how the participants are using the plan. Such knowledge can only be obtained through extensive data analysis. Such an analysis can show, for example:

- where each participant is on the road to retirement security;
- how the various investment options are being used (on both a plan and participant level);
- whether participants are applying in a meaningful fashion the concepts of diversification and asset allocation;
- if various demographic groups of participants behave differently with regard to the plan (such as participation, contribution levels, asset allocation, use of lifecycle or lifestyle funds);
- how the different available tools and services (such as advisory services and managed accounts) are being utilized by participants.

(Fiduciaries also have other important duties. Those responsibilities, however, are beyond the scope of this paper.)

If such data analysis is done routinely, fiduciaries and providers will be able to identify the knowledge gaps of their employees, both in general and by specific demographic groups. Then, the fiduciaries and their provider(s) can develop the appropriate communications and/or services and/or programs to address those needs.

The fiduciaries will also be able to compare their findings to those of other 401(k) plans. Surveys of large numbers of plans are frequently performed by consulting groups, and their summaries are often reported in benefit publications. Such comparisons are the basis of another fiduciary obligation: benchmarking the plan against the rest of the industry.

Another question senior management often asks is “Why is it our responsibility to provide investment education when ERISA does not require us to do so?” If that were the only question, then perhaps the answer would be “It isn’t your responsibility to educate employees”.

However, that question cannot be asked in isolation. It must be accompanied by another one: “What value are the participants getting for all the money they pay in shareholder fees and fund operating

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

expenses?” After all, one of the most fundamental obligations of a fiduciary is to insure that the participants are not overpaying for the services they receive.¹¹

For example, assume a participant has an account value of \$30,000; the expense ratio is 100 basis points (which works out to \$300); and the cost to administer the plan is only \$150. Does the \$150 in excess of the administration costs buy any real value for the participants (i.e., services and products that are actually used by and helpful to the participant)?

This is not a theoretical question. Think of all the money that has been spent on developing Internet-based advisory services which few participants use¹². In fact, John Hancock’s *2004 Survey of Defined Contribution Plans* found that 77% of participants want to meet with an advisor in person, only 30% want to discuss investment options over the telephone, and just 16% prefer to contact an advisor through the Internet.

The Deloitte Consulting 2003 Annual 401(k) Benchmarking Survey provides just as dismal a picture of the state of Internet-based advice. This survey found that when Internet-based advice is offered, less than 25% of the participants sign-up for it. Of that 25%, less than 30% actually implement the recommendations they are given.¹³

The educational sections of providers’ websites have shared the same fate as Internet-based advice. Perhaps both are too difficult for the average participant to use? Maybe their graphical user interfaces are so poorly or inappropriately designed that they are unappealing to most participants.¹⁴ It could also be that participants have little or no trouble using the software, but the output is not believable, meaningful or clear to them.

Fiduciaries are obligated to address these issues because it is the participants’ (and not the plan sponsor’s) money they are spending (directly or indirectly). Simply assuming that the employees do not care or want to be spoon-fed is not adequate. This position is difficult to justify since it is easy to make a case that it is the fiduciaries, rather than the participants, who do not care.

What is rarely done, however, is to ask if these tools and services are overkill. Perhaps participants want an approach that is understandable, helpful, and believable. To be appealing, the approach must fit into the participant’s lifestyle, whether it is being a single parent, chauffeuring children from activity to activity, or working sixty hour weeks. To avoid being shunned by participants, the approach must start out with “sound bites,” small chunks of information that lead participants to the desired behaviors and hopefully arouse their curiosity to learn more about the topics.¹⁵

For example, a research study conducted by Dalbar has found that traditional enrollment books discourage participation. Employees are not interested in completing worksheets, reading about the

¹¹ Ken Brown and Christopher Oster, “As Returns Sag, Employers Turn Up Heat on 401(k) Fees”, *Wall Street Journal*, September 14, 2004, A1.

¹² In his book, *Technology Paradise Lost*, Manning Publications, 2004, Erik Keller argues that corporate America was inundated with irrational spending on IT projects. The evidence to date suggests that, in hindsight, Internet-based advisory services may fall into this category.

¹³ P.18 of the survey.

¹⁴ In his book, *Don’t Make Me Think: A Common Sense Approach to Web Usability*, QUE, 2000, Steve Krug argues that making web pages inviting and user friendly is anything but simple and fraught with perils. In part, this is due to the conflicting views of designers and developers. An even more important reason may be is that there is no such thing as the average user. Thus, “all web use is basically idiosyncratic.” (p.136).

¹⁵ For a better appreciation of this challenge, see James Gleick, *Faster, The Acceleration of Just About Everything*, Random House, 1999.

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

provider, or having to wade through a section on investment basics. By making a kit more effective, asset flows can increase 23%.¹⁶

All the participants really want to know is:

- Why should I join?
- How much should I contribute?
- Where should I put my money?

The first two questions can be effectively handled by the reports discussed above: *Why you should be investing in the 401(k) plan today!* (Figure 2) and *Caution* (Figure 1) reports. “Where should I put my money?” is a question that is much more difficult to address and to which there is no perfect answer.

The use of lifecycle funds, however, is one approach to this question which, from a fiduciary perspective, is both easy to defend and to communicate. Furthermore, the expense ratios of these funds (for example, Fidelity’s and Vanguard’s) are no more than those of typical stock funds. This last fact cannot be ignored since a strong argument can be made that the average participant does not have enough assets and complexity in his affairs to warrant paying additional on-going asset-based fees for alternative attempts at solutions to this problem—namely, advisory and account management services.

One way of helping participants quickly decide if lifestyle funds are for them is to give them a brochure that explains why these funds are being offered and how to use them. To make the brochure inviting, thus increasing the likelihood it will be read, it should be short, in color, and on nice paper stock. The brochure could also include a personalized gap analysis and an introductory letter, both of which are easy to incorporate using digital printing and modern content management software.

An excerpt from one such brochure is shown below:

Now would also be a good time to review your portfolio’s diversification. Diversification means not putting all your eggs in one basket (in other words, not choosing too few funds or funds that are all of the same type). Poor diversification can increase your chance of losing money if the market heads south. It can also result in your having investments with such low growth potential that, given your current contribution, your chance of achieving retirement security is greatly reduced.

To help you accomplish your goals, we have introduced XYZ Investments Five Targeted Portfolios. Each fund is well diversified, targets a specified retirement date, and is professionally managed.

If you want to use one of the Targeted Portfolio funds, all you have to do is to pick the one that targets approximately when you want to retire and determine how much to contribute. XYZ’s professionals do all the rest. They make all the decisions. Each fund’s investment mix at any point in time depends upon how many years are left until your retirement. The further you are from retirement, for example, the greater is the percentage of stocks in the fund.

¹⁶ Dalbar’s study on what makes an enrollment kit effective, Q_{\max} , was published in early 2004.

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

Have providers, sponsors, and fiduciaries, by their actions, assumed responsibility for helping participants achieve retirement security?

Providers purport that their educational materials and programs are “best of class”. Providers also claim that plan sponsor committees want sophisticated websites and the availability of advisory services regardless of their utilization by participants. An important ingredient to winning an account, then, is the apparent quality of their investment education.

Likewise, sponsors, when searching for a new provider, require candidates for their business to answer in depth questions about their education products and services. In fact, in surveys of participant and sponsor satisfaction, a question that is often asked is: “How happy are you with your provider’s investment education program?” (Plan sponsors often give uninformed answers to this question since they do not monitor participants’ use of the program.)

Sponsors and providers, then, are providing investment education. What they are not doing is routinely monitoring the quality and effectiveness of the education and then making the needed changes. To make matters worse, few in either community ask if their material’s content is outdated, especially when it comes to showing historical returns of the stock and bond markets.

For example, a chart that is often incorporated into enrollment kits and meetings as well as educational sessions is the one that shows the performance of the capital markets since 1926. The results are dramatic. Small-cap stocks have outperformed large ones (S&P 500), and both stock categories have left bonds and t-bills in their “dust” on both a nominal and inflation-adjusted (or real) basis.

What is not stated is that:

- The economic conditions that led to stocks’ superior returns may be gone forever due to outsourcing manufacturing and, now, research and development.
- A increasing number of students of the capital markets believe that the difference in returns between stocks and bonds will become much smaller.
- Some scholars still “favor holding stocks for the very long run.” However, these same academics also feel that the investment horizons of most investors are much shorter in length than the “very long run.” Thus, stocks “are not a guaranteed superior performer over the investment horizon of most investors.”¹⁷

Admittedly, a footnote saying that past performance is not indicative of future performance is included in educational and sales materials. This same comment is also made at meetings with employees. Its value, whether made orally or in print, is somewhat problematic. Lawyers representing disgruntled participants will likely argue that:

- the warning’s positioning on the page as well as its font size encourages the message to be ignored; and
- with regard to meetings, how the speaker presents the warning—such as in a matter-of-fact manner so that its importance is downplayed—is much more important than what is said.

¹⁷ Elroy Dimson, Paul Marsh, and Mike Staunton, *Triumph of the Optimists*, Princeton University Press, 2002, p.210.

Making 401(k) Plans a Win-Win Proposition

Getting Participants to Help Themselves and Fiduciaries to Fulfill Their Responsibilities

After all, the participants' lawyers will further argue, since fees of stock funds are much greater than those of bond funds, providers encouraged investors to invest in funds that maximize the provider's profitability rather than acting in their (the employees') best interests.¹⁸

Yet another issue that must be addressed is cost. Bundled providers routinely offset their recordkeeping and other service costs from asset management fees. In many, if not most, cases where a bundled provider is involved, there are little or no out-of-pocket costs to the plan sponsor. Thus, someone is footing the bill for the sponsor, and that someone is the participant.

If the participants are paying for a service in which they have no control over what is offered or how it is offered, the responsibility for making sure that the educational products are appropriate and delivered in a timely fashion falls on those who do have control—namely, fiduciaries and other representatives of both provider and sponsor.

Contrast the current reality of “more is better” with what is seldom done (since it would be construed as being poor employee relations): the plan sponsor offering a no frills recordkeeping program and a very limited participant website. In this scenario, the sponsor tells participants that funding for retirement is their problem, and it is up to them to solve it. To keep the expenses participants pay to a minimum, “dirt” cheap index funds are used. All other fees borne by the participant are clearly specified.

In this hypothetical scenario, it is obvious who is responsible for educating the participants. The participants must educate themselves.

Final thoughts.

Plan fiduciaries and providers must reexamine what they are doing with regard to investment education and the value participants receive for the fees they pay. Simply put, plans are providing investment education (even if it is not called that in discussions with employees). Further, most observers feel that education has failed.

Unless things change, substantial numbers of employees will not be able to retire. These retiree wannabes will likely view suing their former employers and providers as the only way of reducing their retirement income problems.

Fiduciaries and providers must own up to the fact that they are dealing not only with a legal abstraction, the plan, but also with participants—real life individuals who need money to live on during retirement. Fiduciaries must keep in mind that their retirement materials are filled with illustrations of retirement being a happy time, a scenario which large numbers of participants will likely never reach.

¹⁸ Interview with Eliot Spitzer, *Harvard Business Review*, May, 2004. Attorney General Spitzer's view may lay the foundations for many of the lawsuits against both sponsors and providers for breach of fiduciary responsibility and providing misinformation.

Figure 1: Caution Report

(See next page.)

Caution

You may run out of money during retirement!

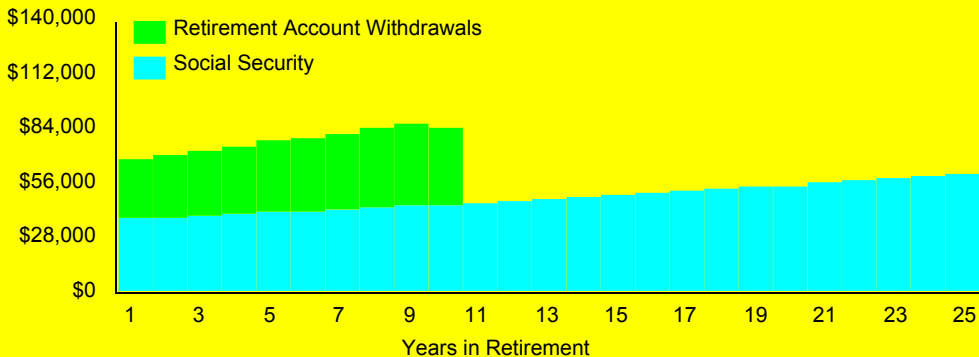
John, using the assumptions at the bottom of the page, if you continue making your current 401(k) contribution of 2.0%, you will run out of money during retirement.

Avoid running out of money. Increase your contribution to 5.9%.

Projected retirement income making your current contribution*

Projected account balance at retirement: \$281,208

Projected balance 25 years later: \$0

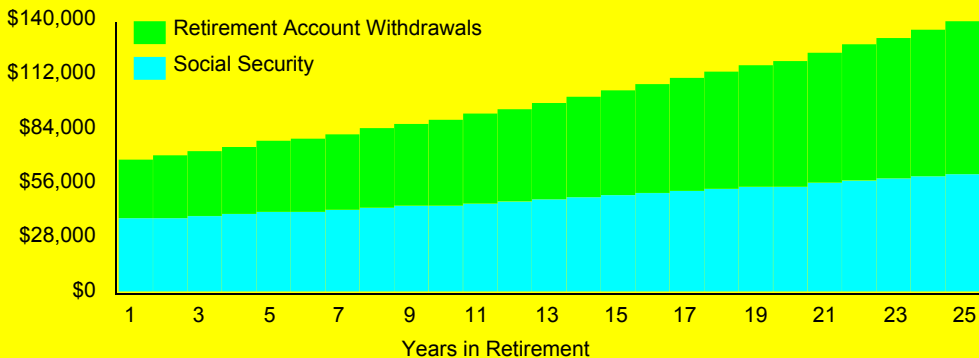


Your contribution	2.0%
Employer contribution	2.0%
Total contribution	4.0%

Projected retirement income making the suggested contribution*

Projected account balance at retirement: \$621,777

Projected balance 25 years later: \$12,925



Your contribution	5.9%
Employer contribution	4.0%
Total contribution	9.9%

* Given the assumptions below, you are projected to need \$67,963 of income in your first year of retirement. Social Security is projected to cover \$37,330 of this amount. Thus, it is projected that you will need to withdraw \$30,633 from your nest-egg in your first year of retirement. In subsequent years, you will need to increase your withdrawals to keep up with inflation.

As the top chart shows, at your current contribution rate, your nest-egg is projected to be consumed after 10 years of retirement. If you increase your contributions as shown, however, your nest-egg is projected to last for your entire life expectancy (as the bottom chart shows).

Assumptions

Current age	35	Social Security benefit at retirement	\$37,330	Pre-retirement investment return	8%
Current balance	\$5,000	Annual increase in Social Security benefit	2%	Post-retirement investment return	6%
Current salary	\$35,000	Post-retirement life expectancy	25 years	Employer match	100% on first 3% of pay 50% on next 2% of pay
Salary growth rate	3%	Inflation rate	3%		
Replacement ratio	80%				
Retirement age	65				

Although this report is based on information about you provided by your plan, it is only preliminary in nature and should not be treated or interpreted as an exhaustive, comprehensive analysis of your total financial situation. In addition, the investment returns, employer contributions, and other assumptions used in this report are for illustrative purposes only and are not predictive of the future. None of the assumptions used in this report are guaranteed. You should periodically review your progress. You might find that you have more or less money than you had anticipated.

Figure 2: Why Invest Report

(See next two pages.)

14 Why you should be investing in the 401(k) plan today

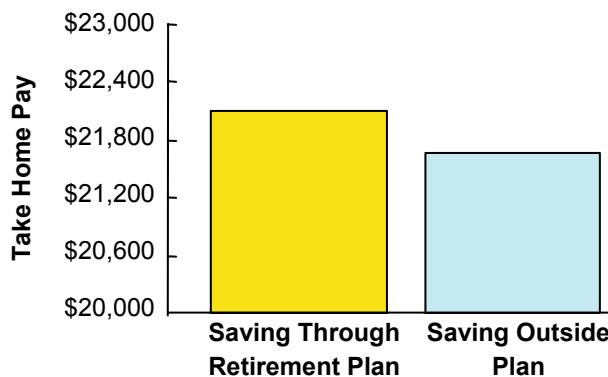
Is the 401(k) plan a good place to invest for retirement?

It certainly is. Because you don't have to pay current income taxes on your 401(k) contributions, your take home pay can actually increase as compared to investing outside of the plan.

For example, if your salary is \$30,000, and you invest \$3,000 in your 401(k) plan, you pay taxes on only \$27,000 instead of \$30,000.

The chart at the right compares investing in the 401(k) plan to investing outside of the plan. You can see how take-home pay is affected.

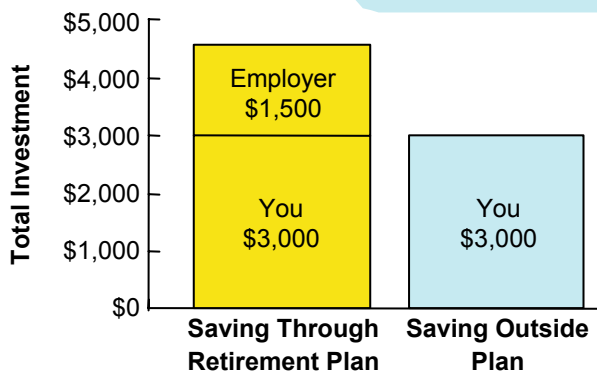
*This illustration takes into account only federal taxes and does not consider state or local taxes. Taxes are based on the IRS 2002 Tax Table for a single filer plus 2002 OASDI and Medicare taxes. The 2002 standard deduction of \$4,700 and one exemption (\$3,000) has been applied in calculating the Federal Taxes. Withdrawals made prior to age 59½ may be subject to a 10% federal tax penalty and are subject to plan restrictions. Taxes are due upon withdrawal from a tax-deferred account.



	Saving Through Retirement Plan	Saving Outside Plan
Gross Annual Salary	\$30,000	\$30,000
Retirement Contribution	\$3,000	\$3,000
Taxable Income	\$27,000	\$30,000
Federal Taxes	\$4,894	\$5,344
Take Home Pay	\$22,106	\$21,656

Increase in take home pay \$450

Does my employer's contribution really give me more "bang for the buck"?



	Saving Through Retirement Plan	Saving Outside Plan
Take Home Pay	\$22,106	\$21,656
Total Savings	\$4,500	\$3,000
Total Amount Working For You	\$26,606	\$24,665

You are ahead by \$1,941

When you invest in your 401(k) plan, your employer will match part of your contributions. The amount of the match depends on how much you contribute and is based on the schedule shown below. The chart at the left shows how much money your employer would contribute if you contribute \$3,000.

When the employer match is combined with the tax savings described above, you can really begin to see the power of the 401(k) plan. The bottom of the chart at the right shows the power of investing in, rather than outside, your plan.

Employer match schedule

- 100% on the first 2% of pay contributed
- 50% on the next 3% of pay contributed
- 30% on the next 5% of pay contributed
- Up to a maximum of \$10,000 per year.

14 Why you should be investing in the 401(k) plan today

Employer match schedule

100% on the first 2% of pay contributed
 50% on the next 3% of pay contributed
 30% on the next 5% of pay contributed
 Up to a maximum of \$10,000 per year.

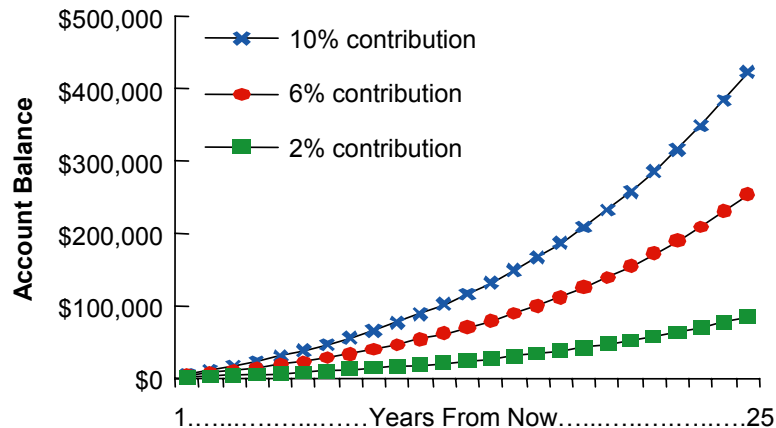
How much can my account grow?

The chart at the right shows how much your account could grow over the next 25 years if:

- your current annual salary is \$30,000;
- your salary increases 2% each year;
- you contribute either 2%, 6%, or 10% to your plan;
- and your employer matches your contributions according to the schedule shown above.

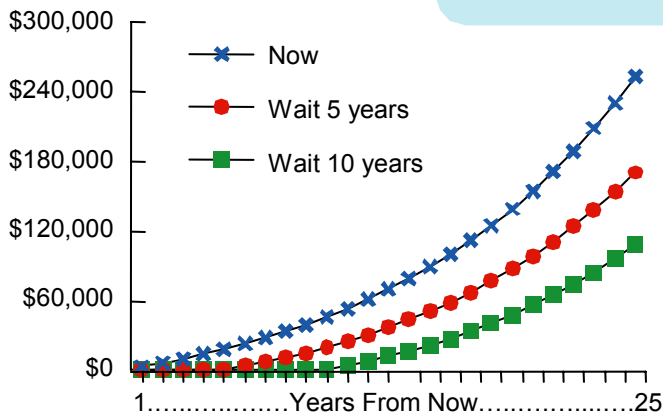
The growth of your account also depends on the rate of return your investments earn. The chart at the right assumes your investments earn 8% each year.

*The figures at the bottom of the chart compare how much your account could grow if you invest in the plan versus outside of the plan. In addition to the tax advantages shown on the previous page, the retirement plan also provides tax-deferred growth which means you do not pay taxes on the growth of your investments until you withdraw the money (which could be over your entire retirement). If you invest outside of the plan, however, you must pay taxes on the growth of your investments as that growth happens. This illustration assumes that, if you invest outside of the plan, 25% of your investment growth will go to pay taxes. Thus, an after-tax growth rate of 6% (75% of 8%) is used when illustrating the growth of investments outside of the plan.



	Saving Through Retirement Plan	Saving Outside Plan*
2% Contribution	\$84,367	\$42,155
6% Contribution	\$253,102	\$126,465
10% Contribution	\$421,837	\$210,776

What if I wait to start investing?



The chart at the left shows how much less you will have in 25 years if you wait 5 or 10 years to start investing. The chart assumes:

- your current annual salary is \$30,000;
- your salary increases 2% each year;
- you contribute 6% to your plan;
- your employer matches your contributions according to the schedule shown above;
- your investments earn 8% each year.

	Saving Through Retirement Plan
Starting Now	\$253,102
Waiting 5 Years	\$170,366
Waiting 10 Years	\$108,196

The investment returns and other assumptions used in this report are for illustrative purposes only and are not intended to be predictive of the future. The investment options you choose may yield lower or higher returns than the returns assumed in this report resulting in a smaller or larger account balance in the future. Neither your projected salary growth rate nor your employer's contributions nor any of the other assumptions used in this report are guaranteed. Federal law and/or your plan may limit the amount you can contribute. Thus, you may not be able to invest as much as shown in the plan.

SIDEBAR

Educational Or Not, Targeted Personalized Communications Can Wake Up Participants

Until the courts decide, whether or not a communication is educational or simply informative is a matter of opinion. For example, are the reports shown in Figures 1 and 2 educational or informative or both? The author views them as wake-up calls whose message to employees is straight forward and blunt—get off your “duff” and start investing for retirement. If education is defined as a process for imparting skills, i.e., empowering someone to perform a set of tasks—physical or mental—then these reports are not educational. If education is defined as enlightening (that is, providing an important message, even a call to a specific action), then these reports are educational.

Regardless of how you classify them, personalized targeted messaging can be very effective (as shown in the table below).

Different versions of the Caution report were distributed to participants and non-participants (the version participants received is shown in Figure 1). About a month after the participants received the reports, either through the mail or at meetings, an analysis was done to test their effectiveness. Regardless of how the report was delivered, its effect on participant behavior was the same.

The Effect on Employee Behavior of a Personalized Gap Analysis		
	Employees who either joined the plan or increased their contributions	Average initial contribution or increase in contributions
300 Non-participants	24 (8%)	7.5%
400 Participants	48 (12%)	4.5%