Changes to Your Retirement Plan are Coming

In wake of stock-market downturn, lawmakers eager to tweak 401(k) rules

By Robert Powell, MarketWatch, Retirement Living

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BOSTON (MarketWatch) -- The financial crisis dealt a huge blow to U.S. retirement savers' 401(k) accounts -- a hit from which many investors have yet to recover despite the market's rally -- and now lawmakers and others are pushing for new retirement-plan rules and policies.

What's likely to stick, and what does it mean for your future retirement? That depends largely on which party controls Congress.

If the Democrats maintain control of the Senate and health-care reform moves off center stage, efforts to overhaul the entire retirement system, including defined-benefit and 401(k) plans, might make headlines by early summer.

If, however, Republicans gain control after the mid-term elections, don't expect major changes to retirement-plan rules. Still, either way, the U.S. Labor Department is likely to tinker with some regulations.

Fee disclosure

If there's one thing experts agree on, it's that a law requiring better disclosure of 401(k) fees is likely -- and necessary.

A number of 401(k) reform measures have been introduced and could receive legislative attention in 2010, including bills written by House Education and Labor Committee Chairman George Miller, D-Calif., and House Ways and Means Committee member Richard Neal, D-Mass.

According to the House committee's Web site, the 401(k) Fair Disclosure and Pension Security Act (H.R. 2989), would:

- Require 401(k) plans to disclose fees on workers' quarterly statements as a dollar figure taken from participants' accounts.
- Require service providers and plan administrators to disclose fees in four categories: administrative, investment management, transaction, and other fees.
- Help workers understand their investment options by providing information on risk, return, and investment objectives.
- Require plan administrators to offer at least one low-cost index fund in order to receive protection against liability for participants' investment losses.
- Require service providers to disclose financial relationships so companies that sponsor 401(k) plans can make sure there are no conflicts of interest.
- Ensure that investment advice is based on workers' needs -- not the financial interest of those providing the advice.
- Provide adjustments to pension funding rules to ensure plans can weather economic crises without providers being forced to cut jobs or freeze plans.

Read the release about H.R. 2989 at this site.

"It remains to be seen whether these measures will advance as a stand-alone bill, as part of broader retirement legislation, or attached to unrelated legislation," said Jason Hammersla, director of communications for the American Benefits Council, in an email.

Some advisers favor greater disclosure, but others say that, absent other information it can be more harmful than helpful.

Aaron Skloff, an accredited investment fiduciary and chief executive of Skloff Financial Group, favors fee disclosure. "Participants will gain a clearer picture of what fees they are paying on certain investments, certain transactions within the plan and overall plan fees."

But disclosure does bring unintended consequences. Participants might stop investing altogether if the plan has excessive fees or they might stop contributing beyond the company match. But if that's the case, Skloff said they can simply "supplement their retirement savings by contributing to an IRA, a taxable account or no-load, tax deferred annuities."

Also, investors who become sensitive to fees could become overly conservative, said Jodi DiCenzo of Behavioral Research Associates, LLC.

"The money-market fund may be the lowest-cost fund in the line-up. If participants are coached to look for the lowest-cost fund, they could end up with portfolios that are way too conservative," DiCenzo said.

Then again, such disclosure could get more people to contribute to their 401(k) and some to contribute more, Skloff said. "Like Internet consumers, the more information participants have the better the decision they can make. The same way the Internet has driven more competition and better value for consumers, full fee disclosure should drive more competition and better value for participants."

Then again, it's possible that fee disclosure won't affect behavior at all. "Unfortunately, work by behaviorists suggests that making fees salient won't have much of an impact on participant decision making," DiCenzo said. "Even though this legislation is likely to pass, it probably won't make much of a difference."

Investment advice

The Labor Department last year put the kibosh on the Bush administration's plan to have mutual-fund and brokerage firms provide investment advice to 401(k) participants. But experts predict the current administration will issue investment advice rules. "The new rules are likely to more clearly define who can provide unbiased advice," Skloff said. "Unfortunately, they are likely to legitimize a wide array of biased advice providers -- wolves in sheep's clothing. Remember, biased advice could actually be more harmful than no advice at all."

For its part, the House Committee on Education and Labor approved a bill last year that would mandate certain 401(k) fee-disclosure requirements, and require that investment advice provided to employees regarding employer-sponsored retirement plans be independent and free of any conflict of interest.

Retirement paychecks

Right now, most Americans with a 401(k) know what they contribute but they don't know how much retirement income their plan will produce or how long their nest egg will last. The contribution is defined; the benefit isn't.

"American workers need a more complete snapshot of their projected income in retirement," said Mary Liz Burns, senior manager for media relations in economic security issues at AARP.

One measure addressing that need could become law in 2010. The Lifetime Income Disclosure Act, S.2832, was introduced by Senators Jeff Bingaman, D-N.M., Johnny Isakson, R-Ga., and Herb Kohl, D-Wis., in December. It requires plan sponsors to tell workers the projected monthly income they can expect at retirement based on their current account balance. Read about the legislation at this Web site.

Automatic IRAs

Lawmakers are likely to reintroduce in 2010 two bills -- S.1141 and H.R.2167 -- that would require small- and medium-sized businesses to automatically enroll their employees into an IRA, according to Investment Advisor magazine, a trade publication.

Both the Senate bill, sponsored by Bingaman, and the House bill, sponsored by Rep. Neal, are called the Automatic IRA Act of 2007. Read about those bills at OpenCongress.org by searching for the bill name and number.

About half of all workers cannot save for retirement at work because their employers -- mostly small companies -- don't offer retirement plans, according to AARP. What's more, very few of those workers open IRAs on their own.

Under the Auto IRA bills, "Employers that do not currently offer a retirement plan would be required to offer payroll deductions to individual retirement accounts," AARP reports. "However, employers would not maintain the accounts, nor would they make contributions. Workers would be automatically enrolled in the accounts at 3% of their wages or salary, and the level of savings would rise annually to a certain maximum. All employees would have the opportunity to opt out of the automatic-savings plans." Read more about AARP's view at this Web site.

But not all agree Auto IRAs are the way to go. "There is no question that we need to come up with solutions that expand plan coverage in companies with less than 100 employees," said David Wray, president of the Profit Sharing/401(k) Council.

"Our view is that you can best do this by simplifying the rules for small-employer plans," he said. "It is questionable whether imposing another government-imposed requirement on small businesses, which are already heavily burdened by government regulation, like the mandatory IRA program makes sense when we need small businesses to expand their work forces."

Still, the AARP and others think the Auto IRA is a must. "AARP has been working with small business leaders to explain the benefits of auto IRA, work through any administrative challenges and look for acceptable methods to manage these accounts for workers," AARP's Burns said.

Target-date funds
Target-date funds are now one of the fastest-growing types of investment within 401(k) plans, but they're under the microscope in the wake of uneven and poor performance in 2008 and 2009.

Some background: Investors typically match their anticipated year of retirement with the name of the fund. For instance, those planning to retire in 2020 would purchase a fund with 2020 in its name. The beauty of these funds is that, as the fund nears the target retirement date, fund managers reduce the percent invested in stocks and increase the percent invested in bonds and cash. In theory, these funds become less risky over time, which is exactly what retirees usually want.

Target-date funds became popular because they make it easy for retirement savers. You buy one fund, and instead of trying to figure out your risk tolerance, investment objective, and time horizon, you simply determine your time horizon. Instead of rebalancing your portfolio every year, you leave that to the manager.

But in the market downturn, funds with the same target date performed very differently. Now, in the wake of a joint hearing by the Labor Department and the Securities and Exchange Commission last summer, changes are likely. What those changes will be, however, is anyone's guess. Read witness testimonies from the hearing here.

What the public wants
It's not easy to get a read on what sort of retirement-plan changes American savers would like. According to a survey by the Investment Company Institute, the lobbying group for the mutual-fund industry, Americans don't want the following: They don't want Uncle Sam to remove or reduce tax incentives for retirement savings, make investment decision for them, take away their ability to invest in their defined-contribution accounts, or replace all their retirement accounts with a government bond. Read the ICI study at this Web site (PDF).

The 'wish list'
For his part, Wray is hoping that Congress doesn't make any major changes for at least five years.

"With the passage of the various provisions in the Pension Protection Act passed in 2006 affecting defined-contribution programs, we now have a regulatory regime in place that will permit the employer-sponsored defined-contribution system to reach its full potential," he said. "It is important to understand that reaching that full potential will take several years and that we have been somewhat set back by the current economic situation. Congress should not make major changes to the system for at least another five years."

Don Trone, the chief ethics officer of Strategic Ethos, hopes for other new rules. He wants lawmakers to increase the deduction limits for 401(k) and other retirement plans. "It's needed, but it's likely to be positioned by the Democrats as a benefit only to highly compensated workers," he said.

In addition, Trone called for the creation of tax credits to encourage companies to provide a match. "This could provide the greatest benefit to all workers," said Trone, though lawmakers likely would oppose that idea, he said.

No matter what happens in Congress, the American Benefit Council's Hammersla said plan participants need to be educated on retirement saving strategies. Trone agreed, saying that "investment stewardship training" is key.

"We should continue to fund and support participant education, but the plan sponsors themselves need education," Trone said. He estimated savings of an average of 50 basis points (one-half of 1%) per plan simply through better asset management. "Training and education is a relatively cheap solution, and should get bi-partisan support," he said.

Lastly, Trone and others are calling for a complete overhaul of the U.S retirement system. They say the U.S. should create a mandatory retirement system not unlike those in Australia and New Zealand. See related story on how the U.S. retirement system is full of holes.

"It's the only solution to ensure that the average worker will have retirement savings in addition to the Social Security supplement," Trone said. Of course, he said it's unlikely such changes will happen. But it's still on his wish list. "A mandatory solution is not going to be palpable," Trone said, "until it is widely accepted and acknowledged that Social Security won't be able to provide the average healthy worker a retirement supplement."

Robert Powell has been a journalist covering personal finance issues for more than 20 years, writing and editing for publications such as The Wall Street Journal, the Financial Times, and Mutual Fund Market News.