What You Don't Know About Retirement Plans that CAN Hurt You

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A retirement plan like a 401(k) helps set a clear path to help employees save for their retirement offering pre-tax and tax deferred incentives to invest while providing a nice benefit for employees and employers. In fact, retirement plans remain one of the best tax deductions available. Unfortunately, less than half of all working Americans have access to 401(k) plans.* Perhaps one day 100% of the work force in the United States would gain access. Yet regulatory changes passed last year by the [i]Department of Labor (DOL), plus other key factors add to the likelihood that we may see less of these plans in the future, not more.

There is an untold push and pull tug of war going on in the retirement plan world unseen by most. Let's break down this struggle by starting at the beginning.

The evolution of retirement plans started with old fashioned pensions of the 1960's where investment risk lay squarely on the shoulders of the company sponsoring the plan. If a pension plan was designed to grow by 6% every year and the investments of the fund grew by an amount less than that, it put a burden on the corporation. Further, the risk of paying out the benefits for life of the employee also set with the employer. Over time unfunded liabilities in pension plans became a dangerous liability on corporate balance sheets. For example, right now General Electric has the largest unfunded pension liability in the US made up from employees living longer and fewer earnings than projected. The liability is now at an eye popping $22 billion!** Should we be surprised employers aren't offering pensions as often as they used to?

Over time 401(k) plans gained popularity in large part due to the fact that the risk switched from the employers to the employees as self-directed investment accounts became more popular. Retirement payouts were dependent upon how much employees could save and how long the saved dollars would last and these plans slowly started to replace the old Pension Plans.

Even though some of the responsibility shifted to employees, the 401(k)'s of present day aren't without their risks and problems. Here are some of the major risks and responsibilities to an employer and employee in maintaining a 401(k):

- The person(s) listed in the plan as fiduciaries "may be personally liable to restore any losses to the plan or restore profits made through improper use plan the plan's assets" per the DOL www.dol.gov website. Do employers understand the risk they face by being the plan signer?

- The plan must follow the plan document and keeping the document current with the latest rules of regulations which relies on a great team to keep this in place.

- The 401(k) must properly diversify the investment vehicles allowed in the plan.

- The Plan must be found to pay reasonable plan expenses and the employer must check these costs periodically.

- Even with a 401(k) in place, employees do not contribute enough to saving a meaningful balance in retirement. The average rate of contribution in the United States is 6% of salary – where a minimum of 10% is recommended for those that start young (age 25), and increases to 23% of your pay if you wait until the age of 40 to save!***

- Employers aren't contributing enough to employee plans. US Corporations contribute on average 3% where country's like Australia and Denmark contribute 8% to 11.8% of employee pay.****

In summary, 401(k) plans can be a great tool when used properly. These plans require a lot of work on behalf of the employers who must understand their risk. Once implemented, employees must be educated to contribute adequately and use the plan what it was designed for to provide that nest egg for retirement.

Who is Wealth Management?

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[i] **, ****Source: The Huffington Post, Thursday March 21st, 2013*
*** Source: IPS – Pension Deficit Disorder November 27th 2012*
**** Source: Vanguard, "How America Saves" June 2012*