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How to Fine-Tune Your 401(k)

Employers are rolling out new features to boost retirement savings.

BY Kelly Greene
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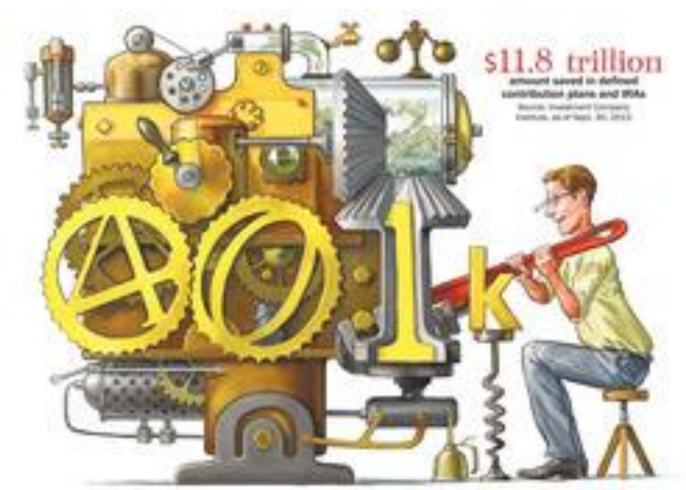
Do you need a retirement-account checkup?

Many of us routinely ignore our 401(k)s and other savings plans for long stretches. Even opening the statements was often painful during the financial crisis.

But after a stellar year for stocks, the balances may now look far more comforting to investors who have a significant portion of their savings in equities, as many do. That presents a timely opportunity for a closer look at what else is different about your retirement plan today.



Matt Collins

Tax-deferred accounts hold an increasingly dominant share of U.S. retirement savings, with an estimated $11.8 trillion in assets as of Sept. 30, or 54% of the total U.S. retirement market, according to the Investment Company Institute, an industry group. That is up from $5.5 trillion, or 47%, in 2000. Most of the money is in employer-sponsored 401(k) plans and individual retirement accounts.

Still, many workers are at risk of being unable to replace a substantial portion of their preretirement income. Employers and asset managers are rolling out an array of tools aimed at helping workers estimate how much money they will need and cajoling them to squirrel away more of their pay.

A small but rising number of workplace retirement plans automatically increase employees' savings rates, unless workers opt out. One new feature will try to harness peer pressure, by letting employees see how their savings stack up against others of the same age, salary or gender. Other innovations are coming.

The latest products and services could benefit employees at risk of falling short of their retirement-income needs. Simply using a basic retirement calculator reduces the likelihood that lower-income investors will run out of money before they die by 14 to 18 percentage points, says the Employee Benefit Research Institute, a Washington nonprofit group that researches retirement and health benefits.

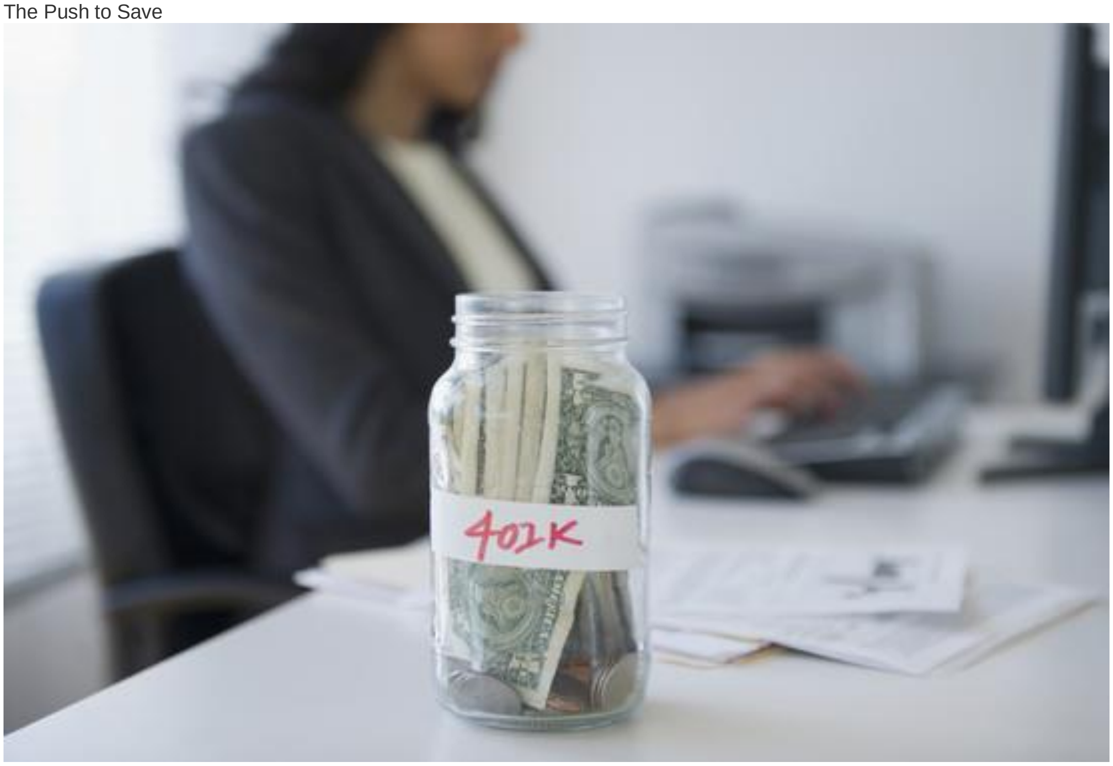
"Employers are spending more money on education. What you get out of it [as a worker] is the ability to invest more in your plan, to invest better and to get higher returns," says Liz Davidson, chief executive of Financial Finesse, an El Segundo, Calif.-based firm that works with employers.

At the same time, employees need to be alert to the potential financial incentives of any advisers and companies that offer advice—even if it comes through a workplace plan, Ms. Davidson says.

Saving enough is important, after all. But employees should be sure they aren't being pushed to invest in mutual funds that charge excessive fees or to pay for services they don't need.

Here is what investors who are saving for retirement through their workplace need to know about the new 401(k) landscape.

The Push to Save



Many 401(k) plans already enroll new hires at a default savings rate. *Getty Images/Blend Images*

Most of the new tools employers and asset managers are introducing try to prod workers to save more.

Many 401(k) plans already enroll new hires at a default savings rate, often 3% of pay, and use a default investment option, typically a target-date mutual fund that adjusts holdings as the worker grows older. Generally, workers have to opt out, rather than opt in.

The problem: A 3% savings rate is likely too low for workers who plan to rely heavily on tax-deferred retirement savings. Financial planners typically advise workers to sock away 10% or more of annual pay.

As a result, some plans will let workers sign up to automatically escalate their savings rate by a certain amount, typically 1% of pay, each year. Other plans do it automatically, and workers have to opt out. A survey of 796 plan sponsors conducted for J.P. Morgan Asset Management found that 43% of plans automatically enroll workers, and 21% put escalating contributions on autopilot, unless workers opt out.

Meanwhile, Vanguard Group, the asset manager based in Malvern, Pa., added a speedometer-like "boost your savings" dial to its website for 401(k) account holders in 2012. The dial shows an investor's current savings rate and suggests possible increases aimed at boosting the odds of replacing preretirement income.

Account holders can turn the dial to the savings rate they want and submit a request to lock in the change. Of the 480,221 participants who saw the tool from December 2012 through May 2013, 9% used it to increase their contributions, according to a study from the Michigan Retirement Research Center.

"It's clear that it's having an impact," says Cyndy Pagliaro, a research analyst at the Vanguard Center for Retirement Research.

These efforts are getting increasingly sophisticated. Putnam Investments, a Boston asset manager, said on Tuesday that it plans to roll out a "social-comparison" tool in April.

Workers with accounts in defined-contribution plans that Putnam administers will be able to see how the rate at which they are saving and the proportion of current income they are on track to be able to replace stacks up against their peers, based on age, salary and sex.

They also will be able to see how they compare to the 10% who are saving the most in their peer group. "People like to understand what that top group is doing, and they like to take steps to be like that top group," says Edmund Murphy III, head of Putnam's defined-contribution business.

These kinds of tools can be useful for workers who aren't saving enough. Companies also have good reason to want to help employees put their financial houses in order: An individual's financial situation was the most commonly cited stress factor in a 2013 survey of more than 2,800 workers and their dependents by benefits consultant Aon Hewitt. And 51% of the workers surveyed said that stress hurt their productivity.

Yet in weighing savings suggestions and using such tools, employees should keep in mind that retirement saving is far from a one-size-fits-all proposition. A 401(k) account, for many households, is just one piece of a broader financial plan.

It is important not to lose sight of other potential sources of income in retirement, including spousal pensions, Social Security, annuities and even home equity.

Evaluating Future Needs

For workers trying to decide how much to save, it is particularly important to figure out how their savings, and their savings rate, will translate into income in retirement. Unfortunately, making that calculation is complicated.

Many 401(k) plans offer tools that try to project future retirement income, so workers can compare it to their current income and their expected needs down the road.

Putnam, for example, offers another tool to participants in 401(k) plans it oversees that generates a retirement-income figure based on an investor's current account balance, an estimate of future contributions and earnings, and any outside investments the participant wants to include in the calculation.

BlackRock, the New York-based asset manager, in July rolled out a tool that aims to help employees between the ages of 55 and 64 calculate how much they need to save to generate a specific lifetime income starting at age 65.

To try to figure out how much each dollar in savings likely will generate, BlackRock factored in the cost of annuities, interest rates and life expectancies, among other items. Employees provide their age and current savings to tailor the calculations.

One problem with such tools, however, is that there is no agreement on which approach generates the most accurate result.

Indeed, the U.S. Department of Labor, which regulates 401(k) and other defined-contribution plans, last year asked the retirement industry for suggestions on how to show savers how much monthly income their assets might provide in retirement. The response was so overwhelming that Labor officials are still digging through the comments. (The department's own income calculator is at dol.gov/ebsa/regs/lifetimeincomecalculator.html.)

Of course, a catastrophic illness or prolonged market downturn in the first few years of retirement could wreak havoc on the best-laid plans. And estimates of income needs depend on many assumptions—including educated guesses at future market returns.

Therefore, employees should remember that calculators provide, at best, ballpark estimates—not guarantees of what will happen. It can be useful to have a rough idea of how close you are getting to your goals, so long as you realize the estimates could turn out to be off-base.

Getting an Education

Employers also are promoting the concept of "financial wellness."

Just as they have used health-insurance discounts, gift cards and other incentives to lure workers to pursue fitness goals, they are offering seminars that aim to help 401(k) participants become savvier about investing.

"Instead of focusing more narrowly about why [the 401(k)] is a good benefit, it's shifted to the importance of being financially healthy," says Ms. Davidson of Financial Finesse.

Workers who take advantage of investor-education seminars typically learn how to rebalance their holdings, stick to an appropriate mix of assets such as stocks and bonds, and select low-fee investment funds, she says.

Some employers are even pondering whether to offer financial incentives, such as adding 1% of annual salary to the 401(k) accounts of workers who participate in seminars about investing for retirement, Ms. Davidson says.

While some workers can benefit from learning about investing, however, others could end up being more vulnerable to pitches to buy investment products that are too risky or expensive.

Therefore, before signing up for seminars or advice, employees should find out whether the people providing it are considered plan fiduciaries, meaning they are required by regulators to act in the investors' best interest. Also, ask to have any fees disclosed.

How to Consolidate

When employees change jobs, that can create another problem—"orphan accounts" with prior employers.

Some workers don't know how to make a switch, or even how to evaluate whether a switch is a good idea. Some find the paperwork involved in moving assets to a new employer's 401(k) plan confusing or time-consuming.

"People have a hard time doing it, even though it can have lower fees and access to funds not available in the retail market, as well as protection from creditors," Ms. Davidson says.

Employees also can be delayed by a waiting period for rolling their old assets into a new plan—and then forget to complete the process, according to a March 2013 report by the U.S. Government Accountability Office.

Also, asset managers may steer workers into IRAs instead of a new employer's 401(k), meaning they may wind up paying higher fees than they would in a workplace plan that has bargained for cheaper investments, the GAO found.

And workers simply cash out an estimated $74 billion a year from retirement accounts when they change jobs, according to an earlier GAO report, rather than parking those investments in old accounts or moving them to a new employer's plan.

Retirement Clearinghouse, a Charlotte, N.C., company that works with retirement-plan administrators and employers to offer retirement-account consolidation as an employee benefit, recently opened up the service to individuals as well.

"It's not like you can't do this yourself. But normal people will look at the paperwork required and think, 'Maybe I should do something else with my time today,'" says Chief Executive Spencer Williams.

David John, a 63-year-old senior strategic policy adviser for AARP, the advocacy group for older Americans, tried to roll two retirement accounts from a previous job into his current plan last year. But he dropped the ball, he says, after contacting the plan administrator and getting "a long paragraph back telling me all the various things I'd have to do. I said, 'I'm going to have to think about this on another day.'"

If you have old 401(k) accounts hanging around, compare the fees in your old accounts against the new one. If they have similar costs, it is worth consolidating them.

First, find out whether your employer offers a service that would help you do it. If not, you may want to attempt the process on your own. But if you get bogged down, consider tapping an accountant or financial planner you already work with for help.

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