

# The automatic revolution: For 401(k) plans, new rules provide for better investing by default

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The decline in the number of American workers covered by traditional pension plans has placed a bright spotlight on the strengths and weaknesses of 401(k) savings plans. Originally designed as a supplemental savings program, 401(k) plans have emerged as the primary source of retirement income for private-sector workers in the U.S. When employees save and invest wisely, the plans can be an extremely effective vehicle for accumulating retirement wealth.

Unfortunately, not all employees make optimal use of their 401(k) plan. Nearly one-third of eligible workers don't participate; many that do, fail to save enough or make poor investment decisions. To address these concerns, Congress incorporated several 401(k) provisions in the Pension Protection Act of 2006. The Department of Labor took an important step under the PPA by issuing on Oct. 23 final 401(k) default investment regulations, which encourage employers to direct or "default" worker money into professionally designed investment portfolios.

Under the new rules, which take effect Dec. 24, the DOL designated balanced funds, lifecycle funds and managed accounts as "qualified defaults." As a matter of public policy, federal regulators have endorsed the notion that balanced investment strategies should serve as the default investment portfolio for workers unable or unwilling to make decisions themselves. Employers that default participants into these investment options will now receive additional fiduciary protection.

This change in policy emerges as the result of an evolution in thinking about 401(k) plans. In the original conception of the 401(k) plan, employees were active decision-makers, expected to make all key savings and investment choices themselves. Today, however, we recognize that many workers lack important financial skills to manage their own savings. Inertia and indecision are hindrances to effective portfolio management. In short, participants need more help.

Forward-looking plan sponsors have sought ways to turn inertia and inaction into a positive force for participants through what is called the "automatic" or "autopilot" 401(k). Under the automatic 401(k), employees are enrolled in a savings plan unless they decide to opt out, their contributions are automatically

increased over time and their savings are directed into appropriate investment options. By default, they are set on the course toward retirement security.

According to the Employee Benefits Research Institute, Washington, employees like the plans, with more than 60% of workers feeling favorably toward individual automatic 401(k) features.

Historically, employers chose conservative fixed-income investments, like money market or stable value, as the default for workers portfolios under the assumption that participants would eventually take control of their accounts themselves. This, too, failed to jibe with actual participant behavior. Once enrolled, few workers took the initiative to shift out of conservative portfolios.

The enormous benefits of an automatic approach combined with professional management have caught the attention of policymakers.

Together, Congress and the departments of Labor and Treasury have acted to encourage all companies to adopt automatic 401(k) plan features with appropriate default investments. With the new DOL policy in place, plan sponsors will be encouraged to place 401(k) participants in professional managed investment options — the same approach they take in managing traditional pension plans.

It is now time for employers to act and take advantage of the incentives that Congress and the Department of Labor have given them to implement the automatic 401(k). As a nation, we can't afford for the 401(k) to not be successful.

Thanks to the support given by Congress and the administration to the automatic 401(k), it is possible for more American workers to have their retirement savings invested in a suitable portfolio strategy. It remains only for more employers to adopt these automatic features, so that all American workers, "by default," will achieve greater retirement security.

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