New laws help employees figure out 401(k) plans

by Lynn O'Shaughnessy

Right about the time last summer when stores were discounting their beach umbrellas to make room for back-to-school stuff, Congress heaved a fat slab of legislation at the feet of the retirement industry. It was the biggest piece of legislation to hit the pension world since Gerald Ford was president.

It will take years to know for sure what effect the 900-plus-page Pension Protection Act of 2006 will have on Americans' ability to retire with dignity, but some things are already known.

To their credit, the creators of this retirement grab bag recognized that Americans routinely make a hash of their 401(k) choices and desperately need help. The 401(k) legislative changes that have received the most attention are aimed at helping workplace sloths.

To its credit, the act encourages companies to automatically sign up employees who never get around to completing their enrollment paperwork. Just as importantly, the government permits a broader range of so-called default investments for these unwitting enrollees.

In the past, companies that automatically enrolled the slackers were usually timid. They'd direct the money from these workers into something supersafe - such as a money market fund - because they feared these investors would run to trial lawyers if the markets couldn't steer out of a nasty U-turn. Thanks to the act, companies can be more emboldened to direct the money to investments that will generate higher returns.

Of course, these provisions are going to benefit only the kind of people who would never spend a Sunday morning reading a financial column. But what about all the conscientious workers out there? These are the folks who already contribute to their workplace plans, but they worry that their investment strategy is as intelligible as the pasta letters floating in a bowl of soup.

I can relate to this fear because that's how I felt as a young reporter when I enrolled in a 401(k) plan at the Los Angeles Times. When faced with a mere four investment choices back then, I toyed with using the eeny, meeny, miny, moe approach but settled on something equally boneheaded. I spread the money equally over the four choices because there was nobody there who could stop me.

While no one expects workers to conduct their own angioplasty or mammogram, they are routinely expected to know enough about investing to keep their workplace cache of money not only healthy but also growing nicely. Obviously, this is horribly unfair.

A big reason why companies have allowed their workers to muddle through their choices by their lonesome is corporate timidity. If companies start providing meaningful advice to workers, somebody in the mailroom or in the sales force might sue if they lose money. Worried by this potential threat, corporate America abandoned its responsibilities and played it safe.

Instead of receiving worthwhile advice, workers are pretty much limited to yearly enrollment meetings where people learn how to fill out forms. Folks who wander into the room might be handed brochures with nearly meaningless pie charts that are probably tossed in the nearest wastebaskets.

To its credit, the pension legislation aims to change this sorry situation. Title VI of the act addresses how personalized advice can be dispensed to the millions of workers who need help. The government has flashed a green light for companies that would like to hook their workers up with financial professionals who can provide individualized advice.

Instead of circulating vague generalities - invest more in stock funds if you're aggressive and more in bonds if you're timid - some workers will have the opportunity to ask questions like these: I'm seven years away from retirement and I've got $150,000 in my 401(k). I've spread the money in mutual funds that invest in large and small-cap domestic companies, foreign stocks and bonds. Should I tinker with my mix of funds? Am I on target for retirement? It will be up to individual companies whether they voluntarily provide this type of counseling.

Beyond that, much remains unclear.

For instance, what will these counseling sessions look like? It's one thing if everybody works in the same town. But what if a company employs tens of thousands of workers scattered around the globe? Investment advisers might be used at some firms, while in more far-flung workplaces the advice might come through investment computer models and telephone.

Traditionally, however, workers have shunned online 401(k) investment tools. They want someone they can

talk to in person.

The act also addresses conflicts of interest. You certainly don't want advisers recommending funds or annuities because they will receive commissions. To protect workers, the legislation requires that professionals advising workers in one-on-one meetings must be fiduciaries. As such, they are obligated to put the interests of their clients first.

The act calls these professionals "fiduciary advisers." These fiduciaries can counsel workers as long as their compensation remains the same regardless of what mutual funds they recommend or what the clients ultimately decide to do. There is, unfortunately, a loophole in this compensation mandate if workers receive advice through computer models.

There is also the question of what fiduciaries should do if a company's 401(k) menu of investments is abominable - and many are.

The move to make the folks in the 401(k) industry behave as fiduciaries is wonderful for workers, but it could cause problems for some brokers. The interests of their 401(k) clients could conflict with the interests of their own brokerage firms. The legislation could also affect the rest of the investment advisory world when customers with large brokerage accounts outside workplace plans begin wondering why they don't enjoy the same safeguards as the guy with a small 401(k) account, says Don Trone, founder and chief executive of Fiduciary360, a fiduciary advisory firm in Sewickley, Pa.

"Why," he asks, "would a client with a seven-figure brokerage account balance want to be treated with less care than a guy with $500 in his 401(k)?"

Why indeed.

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