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Why we do such a lousy job with our 401(k)s

Pending legislation would make it easier to automate retirement savings

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In the roaring '90s, when the stock market was going gangbusters, Nick Bolick, a 42-year-old pilot with United Parcel Service, felt like an investing genius.

His retirement portfolio — including a company-run pension, a 401(k)-style investment plan and investments in blue-chip and technology stocks — was pulling in an annual return of 20 to 30 percent. Life was good — until the market turned south in 2000, wiping away almost half of Bolick's retirement money.

"One minute everything was making money, and then everything went 'pop,'" Bolick said. "I left about 30 percent of my money in mutual funds as a cushion against something like this, but I'd say I lost \$200,000 when the market bubble burst. I've found professional help and bounced back since then, but I'm still probably out \$150,000, and I have about 17 years left before mandatory retirement."

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It's a common story in the aftermath of the market's crash: An investor loads up his 401(k) with stock investments only to see its value slashed by a bear market. But while Bolick's experience is unusual — his company plan allowed him to take greater risks than the average 401(k) investor — it shows how poorly most Americans save for retirement.

The main problem, experts say, is the shift away from company-directed pension plans where all the decision-making was done by an employer. 401(k) plans, named after the section of the Internal Revenue Code that created them, have shifted the responsibility for investing from professional managers onto the shoulders of individual employees. Many of them are either disinclined to manage their own retirement needs or just don't do a very good job of it. And much depends on the shrewdness of their investments in the years leading up to retirement.

"We're asking everyone to become expert savers when they have very little expertise in the field and would rather be doing something else," said Brigitte Madrian, an associate professor of business and public policy at the University of Pennsylvania's Wharton School who has researched employee behavior in 401(k) and other employer-sponsored plans.

But help may be at hand in the form of pending federal legislation that would allow employers to offer plans that are far more automatic, provide financial advice so workers can save more effectively or simply allow employees to hand over the reins to their employers.

The changes are designed to make it easier to sign up for a plan, decide how much to contribute and allocate the assets.

"The evidence shows investors are not doing well, and while there are some who enjoy managing their investments, there's a big chunk of people who want advice and don't really know what they are doing. So there's a movement in the industry toward restructuring savings plans so good things happen with minimal effort on the part of the individual investor," Madrian said.

It wasn't supposed to be this way. Originally envisioned as a supplement to Social Security and corporate pensions, few expected the 401(k) would become the dominant investment vehicle for retirees, supplanting defined-benefit plans, which provide a monthly payment for the life of the retiree.

But when it was introduced in the early 1980s, the 401(k) had distinct advantages from an employer's perspective: It was cheaper than a traditional company pension, and the investment risk was transferred from the employer to the employee. Keen to reduce their future financial obligations to retirees, companies soon started offering the plans in earnest.

Yet not a lot of thought was given to the magnitude of the task the 401(k) imposes on workers, or to their ability to make wise investment decisions, notes Madrian.

Studies show 401(k) holders often fail to diversify properly, or make other mistakes. Many tend to invest too much in the stock of their employer, while others invest too conservatively and have no stock investments at all.

Few plan holders regularly rebalance their investments to maintain the target allocation, nor do enough people move money into bonds and other safer investments as they approach retirement.

Procrastination is a major — and potentially costly — issue.



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"A major problem with 401(k) plans is the average person starts one and chooses five investments when they start out, and they don't change them for 20 years — more than half of the people I see do that," said retirement planner Sam Liang of Rubino & Liang, LLC, who co-hosts a weekly Boston-area radio program focusing on the financial challenges of retirees.

Part of the problem, Liang notes, is a lack of good choices in many plans.

"People get to 50 and want to ease their risk, but the choices in a 401(k) are not good for that, aside from a money market fund [that pays] almost no interest," he said. "So if you are 62 and you have enough money and want to preserve capital, your choices are limited."

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