

IT'S TIME TO FIX THE 401(K)

THE 401(K) PLAN CAN BE A POWERFUL SAVINGS TOOL. BUT FOR MORE OF US TO ENJOY A SECURE RETIREMENT, WE NEED A BIGGER, BETTER IDEA.

By Penelope Wang

(Money Magazine) – Alicia Munnell is a Harvard-trained economist. She served as an assistant secretary of the Treasury and is regarded as one of America's foremost experts on 401(k)s. You'd think she'd be terrific at managing her own retirement, but even she has to fess up to some mistakes. "When my son got married, I took some money out of my plan to help," says Munnell, who heads Boston College's Center for Retirement Research (CRR). "And I ended up paying a 10% penalty and taxes."

In the jargon of the retirement business, that's called leakage. It's a common problem: About 60% of job switchers with a 401(k) plan cash it out.

That's just one of the many pitfalls. Lots of people start saving too late, save too little or make missteps with their portfolio. And all of us are vulnerable to risks that we can't control. Your employer might not offer a plan or might choose one with second-rate investments. Or you may hit a market storm at precisely the wrong moment: the year you stop working.



PHOTO: KEVIN CREMENS

Economist **Teresa Ghilarducci of the New School for Social Research** goes further. To ensure that everyone saves from the start of their career to the end, she proposes a mandatory national savings account on top of Social Security. You'd kick in 2.5% a year and your employer another 2.5%. In one version, the tax credit would be a flat \$600 a year for everybody.

Of course, the government can't just throw cash around (recent events notwithstanding). Paying for tax credits would likely mean trimming or eliminating the existing deferrals. Tough sell. No one is talking about touching existing 401(k) balances. But if you are a high earner able to contribute the max to your 401(k), you'd pay more taxes under Ghilarducci's plan. Before you throw out the idea altogether, though, consider this: You weren't always in your current tax bracket. A plan for moderate-income earners could have gotten you saving consistently from the first day of your first job. It could do the same for your kids.

Working out the details of this third-tier plan won't be simple. One approach would be to offer a straight-up guarantee. In Ghilarducci's plan, the mandatory savings would go into a

single government fund invested in stocks and bonds. You would be guaranteed a payment based on a 3% annual return after inflation, possibly more if the market did so well that the managers decided they could safely distribute extra gains. "Historically, that's a very achievable rate of return," says Ghilarducci.

Unfortunately, it is also a modest one - over long periods, stocks have generally beaten inflation by six percentage points or more.

All of these proposals require some public oversight of your retirement investments. But when tax breaks are involved, that's inevitable - your current 401(k) plan is already highly regulated. The task is to make the regulation more effective. To see how the current rules fall short, consider the 2006 Pension Protection Act. It encourages employers to sign people up for 401(k)s automatically and to use target-date retirement funds and other diversified stock-and-bond portfolios as the default investments. Money markets and stable-value funds were mostly ruled out as automatic options.

In other words, the government has already started opining on what is and isn't an appropriate retirement investment. The bill has probably helped steer more savers in the right direction. Even so, the investment guidelines were left quite loose, and different fund companies offered wildly different asset mixes. When the market collapsed last year, investors who happened to be in plans that had nudged them into stock-heavy allocations suffered steep losses.

These are tricky issues. We need a visible public forum to thrash them out, and we ought to be drawing on the advice of the nation's top retirement and investing minds.

So why not create a quasi-independent Federal Retirement Security Board? The members of this "Retirement Fed" should represent a range of backgrounds and points of view - academics, small business owners, workers and money managers. The board's first task would be to set better rules of the road for those default plans and work on standards for expenses. But it could also develop proposals for that crucial third-tier savings plan. Getting retirement right is essential to our nation's economic health. Let's give it the attention it deserves.

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