401(k) Plan Investment Choices for Participants Closer to Retirement Age

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In the past two years Americans have lost an estimated $600 billion in 401(k) plans in the worst bear market since the Depression. This huge drop in value has caused Congress to focus more attention on 401(k) plans, especially those that subject older workers to investment choices that are not always in their best interest.

Younger participants can be somewhat philosophical about the reduction in their account value and say – "Thank goodness I'm young; I still have time to recover my losses." For employees closer to retirement, the loss may never be recovered and as a result, their plans for a financially secure retirement may be destroyed. Plan sponsors will be well-served to focus some of their participant education on the investment needs of participants over age 50. This will help these employees make investment selections more appropriate to their age.

ERISA established certain specific requirements for Plan sponsors with regard to:

- Employee Communications Programs
- Investment Policy Statements
- Annual Plan Reviews
- Establishment of a Plan Review Committee
- Diversified Portfolio Investment Options

This article will focus on the last of these items, particularly as it relates to older participants.

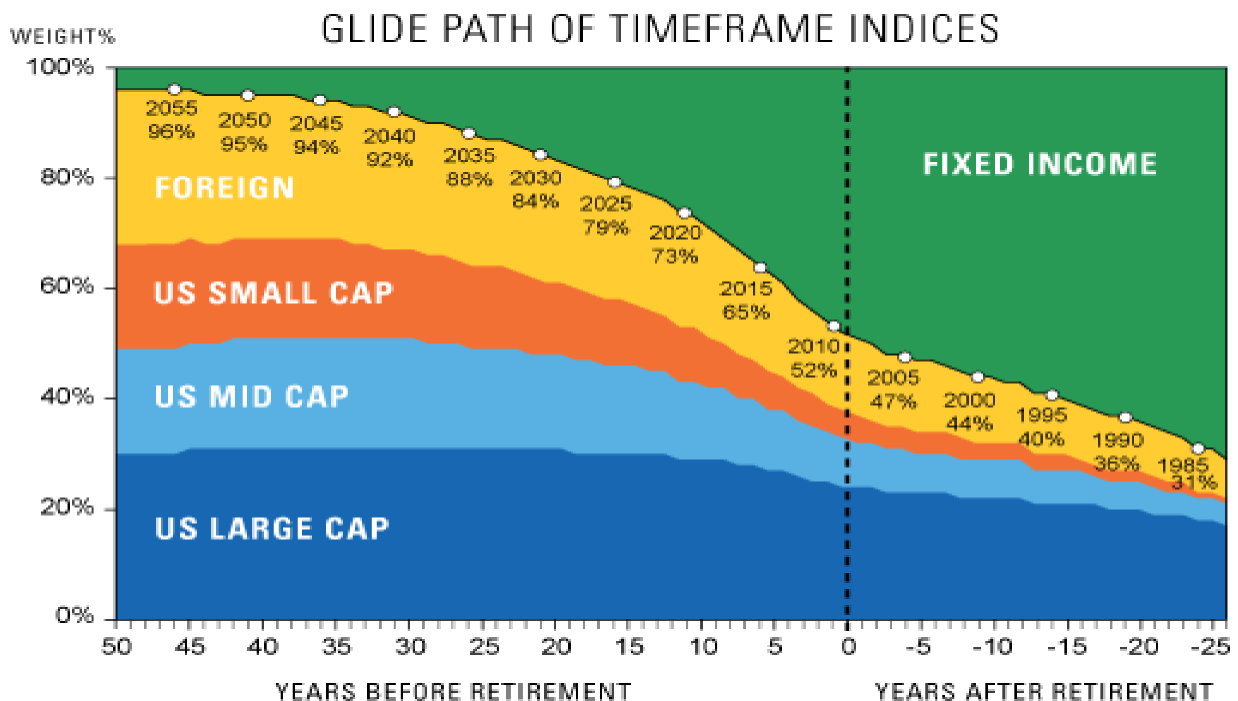
As the market was beginning its decline in 2007, 1 in 4 Americans ages 55 to 65 had 90 percent or more of their 401(k) money invested in stock mutual funds, according to research by Jack VanDerhei, research director at the Employee Benefit Research Institute. The market downturn has highlighted the fact that *many Americans are not educated adequately about investment decisions and fumble mutual fund choices.*

That's dangerous for people near retirement—and probably cut their savings almost in half.

Financial advisers suggest a more conservative approach for participants over age fifty-five – that they limit their 401(k) Plan investments in stocks to about 50 to 55 percent.

During this period, target-date mutual funds failed investors badly too. ("Target-date" is a mutual fund that automatically resets the asset mix (stocks, bonds, cash equivalents) in its portfolio according to a selected time frame that is appropriate for a particular investor.) Such funds employ professionals to choose investments. Despite that, the target-date funds designed for people planning to retire within one year had about 57 percent of their money in stocks. This left near-retirees with losses averaging 26 percent at a time when they will have trouble rebuilding savings.

The following chart from TimeFramePortfolio.com illustrates one approach to the gradual shift from stocks to fixed income investments that should take place as participants get closer to retirement. This is just one example of how this transition can take place.



Lawmakers and senior Securities and Exchange Commission staff were "stunned" by the heavy stock exposure target-date funds gave people on the verge of retirement. This will probably lead to increased scrutiny of 401(k) plans by members of Congress.

Given everything that's going on, now would be a good time for Plan sponsors to communicate with older participants about the importance of monitoring their investment allocations to ensure a proper balance between equities and fixed income securities.

It would also be a good time to offer investment strategies seminars designed specifically for those participants who will be retiring in the next fifteen or fewer years.

These efforts will pay off in improved employee morale and a higher probability that the Plan meets the requirement of Section 404(c) that participants "have sufficient information to make informed investment choices". In both cases, the employer wins.

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This article was a collaborative effort by several of our Ft Lauderdale professionals