401(k)s: They're Not (Necessarily) Just for Employees Any More

By Editor Test *Wed, Mar 24, 2010*

A growing number of 401(k) plan sponsors, retirees, record keepers and regulators want retirees to stay in their plans well into, or even straight through, retirement, PIMCO has found.

Among the things that a retiring employee could traditionally expect from his or her employer – gold watch, cakes, cards, and golf- or gardening-related gifts – they could also be pretty sure they'd soon be booted from the company 401(k) plan.

Since these retirement savings plans were introduced in 1978, companies generally haven't allowed non-employees to hitch a free ride, since the cost of keeping them in the plan outweighed the advantages of keeping their dollars in the plan.

More recently, however, the tide has begun to turn among employers, retirees, record keepers and regulators that could keep more retirees in their 401(k) plans well into, or even straight through, their retirement.

Anecdotal evidence certainly supports the notion that this will become a trend. At recent meetings PIMCO had with 18 large plan sponsors, a show of hands indicated that a decade ago, none of the plans would have considered keeping retirees. But today, all 18 say they want to keep retirees on the plan, and 16 said they are actively developing plans to retain them.

Though it's hard to know exactly how strong the trend will be, the stage is certainly being set for an increasing number of retirees to stick with their 401(k) plans. And it's nearly certain that at least some plans will start to do whatever they can to retain retirees' assets in the years to come, and that many savers will likely be attracted to the benefits of staying in a plan.

The Employer's View

Companies have traditionally wanted to get retirees out of the plan as fast as possible because they didn't want to foot the bill for administrative tasks, answering questions and dealing with ad hoc withdrawals for people who were no longer with the company. Compounding this was the even larger problem that they simply didn't have the administrative capability to write the regular checks that retirees often need to meet their day-to-day spending needs.

In recent years, however, record keepers have started developing technologies that can help 401(k) plan sponsors more economically meet retirees' needs, including installment plan methodologies that can efficiently make regular monthly payments. It's clear that all the economies and efficiencies aren't built in yet, but as the processes improve and become more prevalent, it will likely continue to diminish employers' aversion to keeping retirees.

As recordkeeping improves, other potential advantages of retaining retirees start to emerge, particularly the benefit of keeping assets – usually the largest balances in the plan – on the plan's books. The more assets in the plan, the more administrative costs are spread out, and the more economical it may be for all participants. Many plans are also finding that not all retirees start drawing money from their plans in the early years, as they rely on other funds such as Social Security or money they've already paid taxes on. So not only do the big balances often stick around longer than the employer might expect, but the retirees do not necessarily require much service beyond simple administration.

The Retiree's View

Just as plans have historically wanted retirees out, there is a whole industry made up of brokers, advisers, planners and certain mutual fund companies that are eager to acquire retirees by rolling over their 401(k) savings. PIMCO estimates that assets eligible for rollover out of defined contribution plans will be almost $400 billion this year alone, and it's clear there will be lots of players competing to manage that money.

For a retiree, this means the options are growing, and each has trade-offs that warrant consideration. On one side of the equation are retirees who don't have, or care to have a full-service financial advisor, whether for cost savings or other reasons. Typically the investment choices inside 401(k)s often have institutional pricing, which can carry lower expense ratios than share classes on other platforms. In an effort to retain retirees, some companies have also begun to build programs aimed at helping savers plan for retirement and offering guidance on how they can meet their goals.

On the other side of the coin, we feel it's abundantly clear why some retirees would want to leave the plan in favor of a full-service adviser relationship. While employers are offering guidance and other services, they are unlikely to completely capture the retiree's total financial condition and therefore are not likely to offer a comprehensive financial plan as a full-service adviser would.

Potential Policy Tailwinds

There also seems to be some political wind blowing in support of policy that makes it easier or more attractive for plan sponsors to retain retirees. Recently, the Treasury Department and the Department of Labor sent a request for information to a broad swath of the financial services industry, looking for feedback on the variety of methods of offering guaranteed lifetime income benefits inside 401(k) plans. Since this was simply a request, it's hard to know if it will lead to regulatory or legislative outcomes. Nonetheless, by canvassing the industry on the subject, the government is showing a clear interest in finding new ways for retirees to get guaranteed lifetime income options, including within employers' 401(k) plans.

A Changing Perception

Since their introduction more than three decades ago, 401(k) plans have been almost exclusively a tool for the accumulation phase of retirement savings, but there is growing momentum towards efforts to make them a credible choice for the decumulation phase as well. As employers make efforts to push the trend forward, advantages are emerging for both the retiree and the plan. With defined benefit plans and Social Security unlikely to be primary sources of retirement income in the future, policymakers are also taking measures to determine whether 401(k)s present a potential platform for distributing lifetime guarantee benefits to retirees.

It's unlikely that plan sponsors will supplant the holistic advice offered by the financial advisory industry, but they do represent an emerging alternative for delivering retirement income.

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