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Retirement Weekly

Opinion: The way we save for retirement needs changing: 5 ways companies can help the 401(k) generation

IBM's pension plan comeback challenges us to build a better retirement system

By Zach Buchwald

The U.S. retirement system has undergone a radical transformation that will impact almost the entire working population. Not long ago, most American workers had the benefit of employer-sponsored pensions that provided a lifetime income stream in retirement. But companies replaced them with savings instruments like 401(k) plans. It was a massive risk transfer from companies to individuals that now requires individuals to make hard decisions about how much to save, how to invest, and how to make their money last.

We are about to experience the consequences of this shift, as the first of the "401(k) generation" begins to retire. They will face a harsh reality: they have not saved enough, they have not invested enough, and their money will not last long enough. The next wave of retirees will live for an average of 20 years in retirement, but their 401(k) plan savings along with Social Security benefits will cover less than half their expenses. Instead, they will have to keep working, or hope that their families or the government will help them. This will create a systemic burden that will strain our society and make it even harder for the next generation to build wealth.

This crisis is an opportunity to fix our broken retirement system. Americans largely depend on their employers for retirement savings, so we need to strengthen workplace plans to make a real difference.

IBM, one of the world's oldest and most successful technology companies, has made some thoughtful changes in how it helps employees prepare for retirement. Starting in 2024, IBM will stop matching its employees' 401(k) contributions and will instead guarantee a prescribed rate of return in its old pension plan.

Clearly this change will save IBM money in reduced matching, and will directly reduce its cost basis. But it also reduces the investment risk for workers, and can be converted at retirement into a stable income stream — thereby offering clear advantages for both IBM and its employees. Best of all, it provides greater certainty in the retirement outcome, and shares the retirement savings burden between employer and employee.

The changes at IBM show how we can rethink retirement plans to better serve all constituents. An ideal model will blend some of the positive features of 401(k) plans like portability, tax benefits, and wealth growth with the stability, employer contributions and lifetime income feature of pensions.

Fortunately, we can work within the architecture of the current 401(k) model to achieve the most important goals:

Automate both employee contributions and employer matching. People tend to save too little and too late, and employer matching is often inadequate or burdened with complex vesting rules. Contributions to retirement plans should become automatic and always be paired with fair employer matching.

Make retirement investing more accessible. 401(k) sponsors should simplify their plan design by offering fewer, less complicated options at low fees. This will help participants avoid confusion and stay invested for the long term.

Resist the digital age. Participants can now change or withdraw their 401(k) investments with a few clicks. This is one case where easy access actually harms the individual, because it can lead to impulsive trading decisions which tend to lower long-term returns and also result in penalties and taxes. Trading decisions should not be so easily accessible — instead the technology should be used to drive financial literacy and transparency.

Provide lifetime income in the plans. People that do save enough during their working years tend to hoard their assets in retirement because they worry about outliving their savings. These folks need lifetime income products, such as an annuity inside the retirement plan. A small number of employers offer "institutional annuities" in their plans today, but this feature should be normalized to provide retirees with dependable lifetime income.

Invest 401(k) assets in tax-advantaged programs at retirement. Most people move their 401(k) assets to financial advisers when they retire. These assets should always be managed with taxes in mind. Some advisers today use models that boost after-tax returns and cut taxes by an average of 2% compared with regular mutual funds. This is a big advantage and should become standard for retirees' accounts.

We have blueprints from around the world that show how effective these features are: Australia mandates employer contributions; Canada and the U.K. have made tax-free investing standard in retirement accounts; and of course, here in the United States, Social Security (for all its challenges) was set up to provide lifetime income to retirees.

Retirement security boosts the productivity and competitiveness of the economy, and there is strong support from across the political spectrum to improve the retirement model. IBM recognized this, and so should all corporate leaders. This is the rare opportunity for a winning arrangement among employers, employees, and society at large — to improve the quality of life for employees in retirement, and to create a shared stake in the future of our country.

Zach Buchwald is chairman and chief executive of Russell Investments, a global investment solutions firm that serves institutional investors, financial intermediaries, and individual investors.