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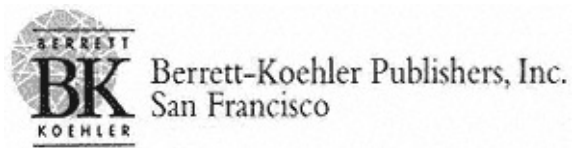
401(k) Today

Another Book by Stephen J. Butler
The Decision-Maker's Guide to 401(k) Plans

401(k) Today

Designing, Maintaining & Maximizing Your Company's Plan

Stephen J. Butler



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PREFACE

In 1995 I authored *The Decision-Maker's Guide to 401(k) Plans*, a book written to meet the needs of company owners, CFOs, human resource professionals, CPAs, and people generally charged with the decisions leading to the design and purchase of a 401(k) plan for their companies.

Since then, laws have changed and many more 401(k) plans have been started. A new book is needed to help plan sponsors improve their existing plans.

Perhaps the most important change in recent years has been the increased interest and involvement of participants in the operation of 401(k) plans. This new book is as much for plan participants as it is for plan sponsors.

The magazine *Smart Money* describes 401(k) "crusaders" who are ". . . rising up and agitating for retirement plans they can really retire on. Increasingly, across the country, participants are dictating in varying degrees how their 401(k)s will be run. Ad hoc committees are forming, and concerned employees are taking steps to influence decisions that impact their savings." 1 Margaret Mead is reported to have said, *Never doubt that a small group of thoughtful, committed citizens can change the world. Indeed, it is the only thing that ever has.*

This book is for plan participants who consider themselves to be enthusiastic, intellectually curious, and passionately committed to the opportunity of amassing real wealth, thanks to this great financial invention called the 401(k) plan. It is designed to give these centers of influence a broader understanding of 401(k)s and more clout with their plan's official decision makers.

This growing influence of plan participants puts more pressure on plan sponsors to redesign their 401(k)s to be cost effective and produce the greatest good for the greatest number of participants. This book will help plan sponsors do this.

What This Book is About

In just four years since the first edition was published, major developments have taken place, and they can be categorized generally as follows:

1. New laws and regulations have complicated the administration of 401(k)s, but at the same time created opportunities.
2. The debate about daily versus quarterly valuation of 401(k) plan assets continues, but competitive pressures are allowing plan sponsors to negotiate lower administration costs and make daily valuation a more affordable option.
3. There is a greater public awareness of costs to 401(k) participants and plan sponsors, and there are techniques and methodologies to accurately compare costs between different 401(k) vendors.

This book discusses how 401(k) plans work and how to assess the quality of your plan and redesign it to be better. And in the process of doing this, it deals with the above three critical changes, changes with which both plan sponsors and participants must be familiar.

New 401(k) Requirements

Many new rules have been introduced in an effort to make 401(k) plans easier to administer, but exactly the reverse has happened: things are more complicated. But while there are possible new costs stemming from these changes, there are also new opportunities to deposit more money into the plans. Plans need to be redesigned to capitalize on these changes.

Part One of the book offers a basic primer on how 401(k) plans operate and how to design and administer plans based on the laws and regulations that govern them, including these new requirements, which are discussed in detail.

Plan participants, even those having a basic familiarity with 401(k) plans, will find Part One an excellent way to get a more sophisticated understanding of these plans.

For plan sponsors choosing a company's plan, the information in Part One is critical. Complicated decisions centered on plan design can have a big impact on the ease with which plans qualify for their tax-advantaged status. In many cases today, plan sponsors are left to their own devices to make these decisions, because most vendors are primarily concerned with selling their services. These vendors view the intricacies of plan design and legal compliance issues as a necessary evil, and they do not pay enough attention to them. The responsibility lies with the plan sponsor.

Daily Valuation Versus Quarterly Valuation A New Look

The issue remains as to whether daily valuation with 800-numbers (and now Internet access) is worth what might be an extra cost. The fact is that 401(k) participants demand the service for psychological reasons. The average participant today has owned retail mutual funds in which individual service and a level of immediacy is routine. This makes it difficult for participants to understand why, in a 401(k) plan, their money may only be valued quarterly and why they have to wait several weeks after the quarter to receive their statements. Part One will discuss the advantages and disadvantages of daily and quarterly valuations.

But while daily valuation may still be more expensive, there are opportunities for plan sponsors and participants to negotiate lower administration costs through a technique called *recapture*. Part Two of the book discusses how, in effect, a 401(k) plan of any size can now be purchased *wholesale* instead of *retail*. This major change in the financial services industry is the result of extremely competitive pressures to gain a greater foothold on the lucrative 401(k) asset base. Gaining enough recapture can offset what might have been the additional costs of daily valuation.

Costs

In recent years, no subject related to 401(k) plans has received more media attention than the fees paid by plan participants and plan sponsors. There have been over 50 fee-related articles in consumer financial publications alone. Two articles by this author dealt with how vendors hide plan participant fees from plan sponsors, and how the combined costs for plan sponsors and plan participants can vary by as much as 600% from one vendor to the next.

Money magazine has estimated that the new fee awareness on the part of the American public could lead to savings of as much as \$1.6 billion per year. ² This, collectively, means trillions of extra retirement dollars in people's accounts some thirty years from now.

Part Two of this book discusses the various kinds of costs incurred by plan participants and plan sponsors. But more than that, Part Two arms participants and plan sponsors with the knowledge to compare costs and negotiate successfully with the 401(k) vendor community.

Remember, your interests may not be entirely in line with those of the financial institution operating your company's plan. So, to get the maximum benefit from your plan, it helps to understand the design decisions operating behind the scenes that can stand in the way of optimal results.

For plan participants, Part Two of this book will give the background you need to assess whether your plan is as good as possible from your perspective. With this information, you can constructively suggest to company management that they consider changes in the plan. In doing this, you would not be alone. In a growing movement across the country, there is more employee involvement in the choice of 401(k) vendors and plan provisions. In many cases, employees are forming advisory committees, or entire populations of employees are voting on the vendor selection. Informal advisory committees are forming with much the same spirit as an investment club.

For plan sponsors who are choosing vendors, investments, and design components for their company's plan, Part Two of this book will offer some valuable insight. Sorting through the marketing hype contained in the stack of three-ring binders from all the vendors is next to impossible without some organization or methodology for making an apples-to-apples comparison. Part Two contains a frank,

tell-it-like-it-is story about how the industry works. It offers a simple and comprehensive technique for comparing the important differences between vendors. These tools can also be used to compute a *standard vendor cost* and then compare other vendors against it.

When the information from vendors can be accurately assessed, you can know, beyond a shadow of a doubt, that you have chosen the plan that best satisfies the combined interests of your company and its employees. By selecting the right vendor today, as your plan grows in asset size and the interests of employees become increasingly more important, you can avoid having to make a change in vendors just a few years down the road.

Testing

Another key element of 401(k) plans and one in which regulations have also changed is testing: how the 401(k) plan meets the requirements necessary for it to retain its tax-advantaged status. Part Three of the book discusses testing. It is the most complex aspect of 401(k) plans, but it may also be the most critically important. If you understand testing, not only can you avoid the tremendous cost of a plan losing its tax status, but you can design a plan that is cost effective and allows employees great flexibility in contributing money to the plan.

I have tried to make this complex subject understandable without *dumbing it down*, and I urge both plan sponsors and plan participants to read at least the first chapter in Part Three (Chapter 9), because it deals with the most basic aspect of testing. Those of you who read all of Part Three, however, will be in the best position to use testing to redesign your plan.

Finally, Part Four brings together all of the elements discussed in the book, and shows how to use them to create the ideal 401(k) plan for different kinds of organizations.

Amassing Your 401(k) Fortune

To paraphrase F. Scott Fitzgerald, *The rich are different; they have money*. Today, we can say the same about ourselves as 401(k) participants. We are different. There are over 50 million of us and we

have over one trillion dollars invested in our plans. Studies indicate that we will have over five times more money at retirement than would have been the case in the absence of the 401(k) phenomenon.

Consequently, we all have an interest in information that helps us understand our plans and gauge their costs and quality. For many of us, our 401(k) plan is the most valuable asset we have. A growing percentage of us are now *401(k) millionaires*, according to *The Wall Street Journal*.³ Substantial 401(k) account balances have changed many people's views of their work experience. There is definitely a feeling of smug satisfaction that can come from achieving financial security years before a normal retirement age.

This book gives both plan sponsors and participants the basics of 401(k) operations as well as sophisticated techniques and strategies for designing the best possible 401(k) plan. Based on my 20 years as a 401(k) plan administrator, I know that these techniques and strategies can help you become a 401(k) millionaire.

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Specifically, I owe a great deal to associates I have worked with for many years, including Melanie Budiman, Nicole Fornaci, Julie Sambo, Claudia Bogner, and Laura Straka. Our technical consultant, Cheryl Morgan, has made an especially valuable contribution over the years and deserves her national renown. Also, my editor, Charles Dorris, has been a major factor in helping to turn difficult subject matter into something surprisingly easy and pleasant to read.

I especially want to thank my publicist, David Graulich, for the bridges he has built to the financial press. It has been a pleasure to work together on articles that have popularized the concepts in the book. In the process, we have developed beneficial relationships with a number of key journalists for publications such as *Fortune*, *Money*, *The Wall Street Journal*, and *CFO*, as well as many trade and local publications. This public attention created by Mr. Graulich gave our ideas a level of exposure well beyond the circulation of the book itself.

And, finally, I want to thank my family members who have offered so much inspiration during summer vacations when the core of this book has been written. First, of course, is my wife, Fran,

and my children, Elsa and Mason. Then, my parents, Elsie and William Butler, have been influential as have been my wife's parents, Fran and Mason Knox. Not to be forgotten is my sister-in-law, Marion Barthelme, a fellow writer, and Vaughan Schwarz, Ph.D., a noted psychologist. My brothers-in-law, Steve Schwarz and John Fort, have helped considerably over the years with their legal and business experience. I have a high regard and appreciation for this group's contribution to the process.

**PART 1
ASSESSING AND REDESIGN:
LEGAL CONSIDERATIONS:
WHAT THE LAW ALLOWS YOU TO DO**

Part One of this book discusses the basics of the 401(k) plan that are typically dictated by tax law and pension regulations. These basics include how the plan works, how plan sponsors can contribute matching contributions to the plan, how plan participants can borrow from their plan accounts, and daily valuation of the plan's assets compared to quarterly valuation.

This material will help plan participants and plan sponsors assess and redesign their plans.

Chapter 1

Understanding How 401(k) Plans Work: The First Step

Everyone involved in a 401(k) plan should be curious about how these plans work. Plan sponsors absolutely need to know. But so do plan participants. And while 401(k) plans may appear to be nothing more than a group of employees depositing money into mutual fund accounts, these plans are far more complicated. Understanding these complications defuses the frustration of employees, frustration that arises when a portion of their contributions are returned to them in some years, when they have only a limited number of investment options, and when they can't change their investment mix on any given day.

Understanding the basics of 401(k) operations also gives plan sponsors and participants the first set of building blocks that allow them to redesign the plan to make it more cost effective and more responsive to their needs.

All basic 401(k) plans have certain characteristics:

1. Significant contributions can be made to 401(k) plans.
2. Contributions receive favorable tax treatment.
3. To qualify for their favorable tax treatment, plans must pass certain tests to assure that rank-and-file workers, as well as company owners and highly paid employees, are participating in the plan.