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THE RETIREMENT TIMES

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What Retirement Planning Isn't

Americans believe they need nearly $1.5 million to retire comfortably, a number that has soared by more than 50% since 2020, according to Northwestern Mutual's 2024 Planning & Progress Study. Yet the Employee Benefit Research Institute reports that only about half of workers have actually calculated their retirement needs. Employees can easily latch onto media-hyped, generalized one-size-fits-all numbers without a clear understanding of whether those figures align with their personal financial circumstances.

The conversation around prudent retirement planning should begin with defining what it isn't …

… A Magic Number

Gauging retirement readiness requires knowing more than just someone's 401(k) balance. It demands a comprehensive and integrative approach that accounts for factors like health care, inflation, taxes and lifestyle choices. Shortcuts and rules of thumb like the 15% of income "rule" or the 25x annual retirement expenses "rule" overlook individual needs and differences. For example, higher-than-average health care costs alone can derail even the most disciplined savers, especially with long-term care costs outpacing inflation.

… Determined by Generic Advice

Relying on generic advice can lead participants down a perilous path. Without a personalized approach to retirement planning, workers making decisions based on incomplete or outdated information might result in saving too little or overestimating how long savings will last. The consequences of underpreparing could be devastating, forcing retirees to either return to work or drastically lower their quality of life. On the other hand, overpreparing can also come at an emotional cost if it's driven by unnecessary anxiety and fear about the future.

… a One and Done Decision

Retirement readiness can be — and often is — a moving target. Whatever amount an employee at age 30 projects they'll require is likely to change by their 40s or 50s. Alterations in family composition or needs, unexpected debt or an inheritance, market fluctuations or medical issues can all impact retirement planning. That's why any snapshot assessment of retirement readiness shouldn't be relied on for extended periods of time.

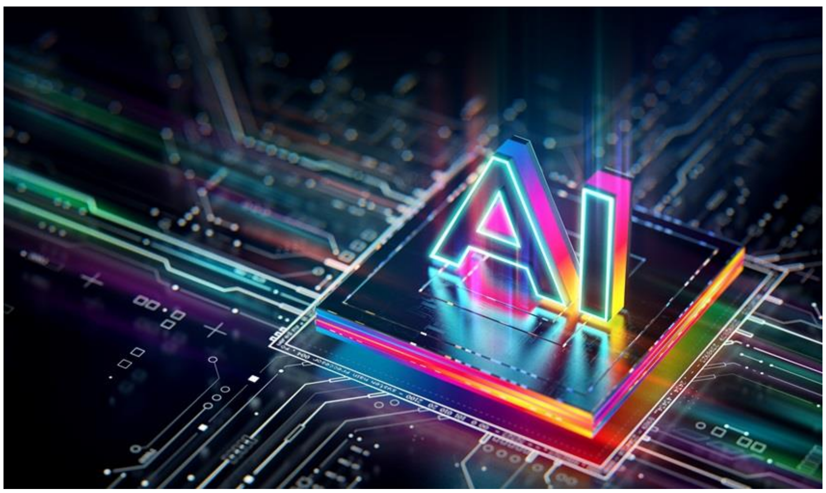
What Retirement Planning Is …

Prudent retirement planning involves a holistic approach and ongoing adjustments. Regular monitoring and check-ins with a knowledgeable advisor help ensure an individual's strategy is on track to meet established objectives. It's making periodic adjustments based on changing personal and economic circumstances — as well as the shifting goals of the future retiree.

The good news is that plan sponsors are uniquely positioned to provide employees with the tools and resources they need for better outcomes. Facilitating one-on-one meetings with an experienced financial advisor can shift the focus from broad-stroke figures to actionable strategies based on calculations that take into account specific circumstances, timely information and any changing wants or needs. Ensure your employees aren't just guessing about retirement readiness by encouraging them to use real data alongside professional guidance so they can have greater clarity — and confidence — in the process.

Sources
https://news.northwesternmutual.com/planning-and-progress-study-2024
https://www.ebri.org/docs/default-source/rcs/2023-rcs/2023-rcs-short-report.pdf

What the DOL's AI Guidance Means for Plan Sponsors



The U.S. Department of Labor (DOL) recently released voluntary guidance emphasizing the importance of ethical and transparent use of artificial intelligence (AI) in the workplace. Titled Artificial Intelligence and Worker Well-being: Principles and Best Practices for Developers and Employers, the document provides a roadmap aimed at helping ensure AI improves job quality while protecting workers' rights and welfare.

Although much of the focus is on workers, the principles also have relevance for plan sponsors. As AI tools increasingly become more integral to retirement planning and financial education, it's important to ensure these technologies are used transparently and responsibly to empower participants while mitigating risks associated with AI.

Here are ways AI can be leveraged in retirement planning with DOL best practices in mind.

Ethical AI and Financial Decision-making
When adopting AI-driven tools for use in retirement plans, plan sponsors should prioritize ethical development and use. AI is increasingly being used to augment investment recommendations and predict retirement outcomes, but it's crucial that machine-learning algorithms remain transparent and free from bias. Poorly designed AI tools could disadvantage certain participants by making flawed assumptions or relying on data sets that are not representative.

To help mitigate these types of risks, plan sponsors should take measures to ensure that AI-driven systems are rigorously tested and continuously monitored. This aligns with the DOL's call for ethical AI development, which aims to protect workers from unintended harm.

Empowering Participants Through Personalized Planning
One of the most promising benefits of AI in retirement planning is its ability to provide highly personalized advice at scale. Instead of relying on more generic recommendations, AI can help tailor investment strategies and financial guidance to each participant's unique situation and encourage them to take actions that align with long-term goals. But as the DOL guidance emphasizes, AI should be used to enable and empower workers, not just automate processes. By facilitating one-on-one meetings with advisors, AI tools can be used in ways that help ensure AI-driven insights are contextualized and validated by professional expertise and judgment.

Transparency and Trust

The DOL also stresses the importance of AI transparency in the workplace. For plan sponsors, this requires clearly communicating how and when AI tools are being used. Employees should understand that while AI can provide valuable insights, it can also be prone to error and shouldn't replace personalized advice and expert guidance.

Sponsors can help build trust by clearly explaining how AI systems work — and how participants can benefit from these advanced tools. Open communication can help ensure that employees feel comfortable incorporating AI into their financial planning process in an appropriate way.

A Prudent Path Forward

By adhering to DOL best practices, plan sponsors can better leverage AI to empower workers, provide more personalized guidance and help ensure that retirement planning is both ethical and transparent. In doing so, they can help workers navigate the complexities of retirement savings with greater confidence and security.

Source
https://www.dol.gov/general/ai-principles

New 401k Rules: Balancing Access and Savings

When considering short-term funding options, participants are often advised to avoid tapping into their 401(k) accounts through loans or hardship withdrawals, as early withdrawals can impede long-term retirement savings. However, the SECURE 2.0 Act of 2022 has introduced more penalty-free emergency withdrawal provisions, offering increased liquidity and flexibility within 401(k) plans. While some see this as a risk to retirement balances, a recent Vanguard study found that participant contribution rates tend to remain stable before and after taking loans or hardship withdrawals.

Increased Accessibility Under SECURE 2.0

Fiona Greig, global head of investor research and policy at Vanguard, went on to say, "I think the promise of [the SECURE 2.0 provision] was that it would cause more people to participate in 401(k) plans or to save more and increase rates in 401(k) plans if they knew that the money was accessible to them in a hardship or a pinch... The downside though, of these expanded liquidity options, is that they could lead to leakage. They could cause more people to take withdrawals and ultimately result in lower balances."

Turning Withdrawals into Loans

According to the paper's authors, plan sponsors should introduce a provision called "automatic repayment" that would enable participants to pay back withdrawals over time through payroll deferrals, much like a loan, in order to encourage retirement savings. This strategy might encourage consistent saving practices even after emergency funds have been accessed. In fact, according to Vanguard data, the majority of participants who made hardship withdrawals or loans in 2021 did not lower their contribution rates afterwards.

The study found that, even after taking a 401(k) loan or hardship withdrawal, participants rarely cut back on their contribution rates. In 2021, 26% of loan takers and 24% of hardship withdrawal takers voluntarily reduced their contribution rates at some time during the two years after issue, according to Vanguard statistics. Approximately the same percentage of participants, 26% of loan takers and 24% of hardship withdrawal takers, voluntarily increased their contributions at some time throughout the two-year issuance period.

Additionally, frequent payroll deferrals help 401(k) loan recipients who stay employed long enough to pay back their loans. Researchers found that most individuals could return a $1,000 withdrawal within two years with a slight rise in contribution rates of roughly two percentage points.

Greig suggests that a feature prompting participants to increase their contributions slightly could help them repay emergency withdrawals more efficiently. Once the loan is repaid, sponsors could encourage participants to maintain their higher contribution rate, thus boosting long-term savings.

The Bigger Financial Picture

Greig points out that while participants seem to manage 401(k) repayments without issue, the study only covers 401(k) data. Broader financial health, such as credit card debt or student loans, may impact participants' overall financial well-being. Rebecca Liebman, co-founder and CEO of LearnLux, notes that "There's a lot of other data that we see in credit card debt, medical debt, student debt, emergency savings data, credit score data … that is impacting these decisions". She continues, "When you're only looking at 401(k) data, you are getting a skewed picture of financial health in your organization, because if you look at the macro trends, people are living in debt. People are pulling that money from somewhere."

Liebman stresses that in order to avoid taking out loans from their retirement plan, members should make sure they have emergency reserves and a debt-payoff plan so they know where they can find liquidity.

Automatic Features' Role in Financial Habits

According to Kelli Send, a senior vice president at Francis LLC, the ability to repay loans does not always indicate that a person's financial situation has improved. "We've made auto features so amazing in 401(k) plans, and it's generally been a very good outcome," She says. "But it has lessened the attention required to manage your 401(k), which may perhaps lead to this positive behavior that Vanguard is seeing."

Send recommends setting limits on 401(k) loans to prevent employees from accumulating multiple loans simultaneously, which could lead to financial strain. While she supports 401(k) loans as a useful option, Send emphasizes the importance of mindful financial behavior and advocates for plan designs that promote continued saving after loan repayment.

Overall, Greig believes that thoughtful plan design can make a significant difference in participant behavior. By structuring 401(k) plans to support faster repayment or continued savings, plan sponsors can help participants maintain strong financial habits that benefit their long-term retirement readiness.

Sources:
https://www.plansponsor.com/are-401k-loans-detrimental-to-retirement-savings-behavior/

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Winter Word Search

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- ☐ **Advisor**
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