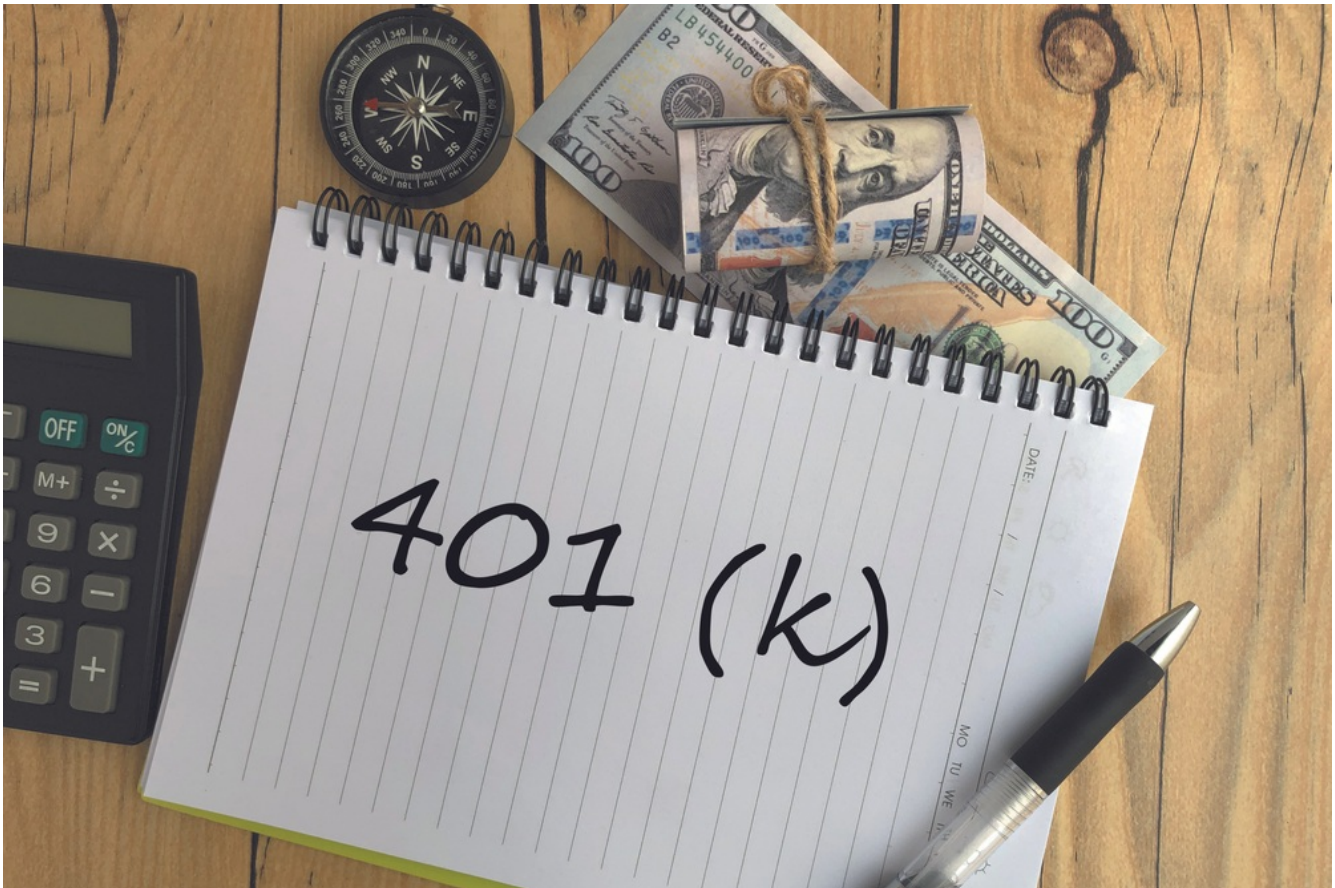


Inflation Takes a Toll on New 401(k) Law's Benefits, Leaving Low Financial Savvy Individuals at a Disadvantage



Inflation-driven cuts in 401(k) contributions and low financial literacy among workers are preventing many individuals from fully reaping the benefits of recently implemented retirement laws. These laws were designed to enhance access and market resiliency. Research conducted by the TIAA Institute and the Global Financial Literacy Excellence Center at George Washington University reveals that a quarter of working adults, across different age and gender groups reduced their nest egg contributions in 2022. Shockingly, nearly half of these workers completely stopped saving for retirement.

Furthermore, data from the Employee Benefit Research Institute indicates that the majority of workers who are cutting contributions in response to market fluctuations following the COVID-19 pandemic are doing so without seeking advice or involving their employers and plan sponsors in the decision-making process.

These findings suggest that the new retirement access laws, introduced through the SECURE Act, may be less effective due to communication breakdowns between workers and their employers. Individuals' short-term decisions regarding their retirement contributions can have long-term consequences, potentially resulting in thousands of dollars in lost earnings and decreased retirement readiness.

Paul Yakoboski, a senior economist at the TIAA Institute, explains that workers often resort to cutting back on retirement savings temporarily to overcome financial challenges. However, this quick fix can have significant long-term implications.

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The SECURE 2.0 Act, signed into law late last year, offers optional provisions for employers to support workers in saving for emergencies, paying off student loans while saving for retirement, and providing in-plan guaranteed lifetime income products. Alongside the SECURE Act of 2019, Congress has encouraged greater 401(k) plan automation, even requiring employers to enroll new hires in escalating contributions.

Despite the presence of automatic features, most participant-directed 401(k) plans still place the responsibility on individuals, who often react impulsively to daily market trends and view contributions as disposable income. According to Andrea Hasler, deputy GFLEC academic director and assistant research professor at GWU School of Business, this poses a messaging problem for employers. Hasler suggests that automatic features should be combined with efforts to raise financial awareness among employees, enabling them to make informed decisions.

Under the SECURE 2.0 Act, automatic contributions will primarily be defaulted into target-date funds (TDFs). However, only 44% of respondents in an EBRI survey claimed to understand the meaning of the "TDF" acronym. This lack of basic investment knowledge hinders individuals' ability to make sound investment choices.

The EBRI's 2023 Retirement Confidence Survey, conducted in collaboration with Greenwald Research, reveals that 70% of savers feel confident about selecting the right investments for their situation. However, the TIAA Institute-GFLEC Personal Finance Index, which assesses financial literacy through a series of questions, paints a different picture. The research shows that less than half of working adults answered the questions correctly, indicating a significant gap in financial knowledge.

Addressing this issue becomes challenging for retirement plan sponsors, as providing financial advice exposes them to potential liability under the Employee Retirement Income Security Act of 1974. Consequently, employers often turn to financial wellness benefits packages and hire third-party coaches to assist employees with financial decision-making.

Andrea Hasler emphasizes the need for workers to understand that saving early leads to long-term benefits. However, this message is yet to effectively reach individuals.

In conclusion, the new set of retirement laws designed to boost access and market resiliency may not benefit investors as expected due to low financial literacy among workers and inflation-driven historic cuts in 401(k) contributions. Workers are going it alone, relying on little to no advice about their savings goals, leaving their employers and plan sponsors out of the loop. Workers need to understand the importance of starting to save for retirement now, even during tough economic times, to be better off in the long run. Employers should raise financial awareness among their employees, making them more aware of what they are getting into.

