MAY 5, 2022

5 ways you can help employees prepare for retirement

Retirement security, or insecurity, has caught the eye of Labor Secretary Marty Walsh. He’s right. Fewer employees are covered by traditionally defined benefit plans. DB plans are retirement plans. The plan sponsor, most likely the employer, bears all the investment risk and pays you a fixed amount every month until you die. It’s a good deal, if you can get it.

Defined contribution plans such as 401(k) plans were never meant to function as retirement plans—they are profit-sharing plans. The two main selling points of retirement plans, back in the 1980s, were lowering your taxable income through pretax deductions and portability—you take your money wherever you went next. But you managed your investments and you absorbed the losses. And when times get tough, employers often suspend their contributions.

The undisputed fact is, however, 401(k) plans have morphed into retirement plans. And employees nearing retirement, and even those who aren’t, are concerned they won’t have enough money to retire. And they’re beginning to blame employers.

Here’s what you can do to help.

Qualified retirement planning services

As with W-4s, the trick with 401(k) plans is not giving advice. If you do, you could be held to a fiduciary standard. But you can allow others to advise employees.

IRC § 132(a)(7) classifies as a tax-free fringe benefit the value of qualified retirement planning services provided to employees and their spouses. Qualified retirement planning services include retirement planning advice and information.

Good: This fringe isn’t restricted to information about your 401(k) plan. It can include general retirement income planning and how your plan fits with employees’ overall retirement income objectives. While this fringe isn’t restricted to near-retirees (even members of Gen Z have retirement objectives), you can’t discriminate in favor of highly compensated employees.

Bad: There are limitations; the principal one being the IRS has never issued any guidance on this fringe. Also, services *related to* retirement advice aren’t excludable. What are services related to retirement? Well, since the IRS has never issued any guidance, it’s never said, but at a minimum, they include tax prep, accounting, legal, and brokerage services.

Help from state governments

Some state tax departments have websites devoted to helping residents reach their financial goals; employees should be encouraged to use them on their own time.

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New Jersey, for example, has introduced NJ FinLit. It features user-friendly interactive tools, videos, and articles employees can use to better understand and manage their financial resources.

There are also tools for budgeting, saving for emergencies, a retirement analyzer, and a paycheck analyzer.

I took the site's *Your Money Personality Test*. No surprises here—I'm a worrier.

Social Security benefits

Everyone knows they'll receive Social Security benefits when they retire, but not how their benefits are calculated. How much retirees will receive depends on their lifetime earnings, whether they're married, single, or divorced, and the age at which they retire.

Here are the basic facts about Social Security benefits.

You need 40 quarters of coverage—10 years of work—to qualify for benefits.

Benefits are stratified, depending on the age at which you retire:

- Retirees can start receiving reduced benefits as early as age 62; the reduction is permanent.
- Retirees who receive benefits when they hit their full retirement age aren't reduced.
- Retirees who delay benefits until age 70 qualify for increased benefits.

Your initial monthly benefit is based on your highest 35 years of earnings, which are indexed to historical wage growth. The highest 35 years of indexed earnings are added up and the total is divided by 420 months (35 years × 12 months). The resulting amount is your *average indexed monthly earnings* (AIME).

Your *primary insurance amount* is determined by applying a formula to the AIME.

- First, the AIME is sectioned into three brackets or segments of earnings, which are divided by dollar amounts known as *bend points*. In 2021, the bend points were $996 and $6,002, In 2022, the bend points are $1,024 and $6,172.
- Second, three different replacement factors—90%, 32% and 15%—are applied to the three brackets of AIME.
- The three products derived from multiplying each replacement factor and bracket of AIME are added together.

Here's an example, courtesy of the Congressional Research Service:

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Table 2. Computation of a Worker's Primary Insurance Amount (PIA) in 2021 Based on an Illustrative AIME of $7,000

Replacement Factors	Three Brackets of AIME	PIA for Worker with an Illustrative AIME of $7,000
90%	first $996 of AIME, plus	*90% x $996* = $896.40
32%	AIME over $996 and through $6,002, plus	*32% x $5,006* = $1,601.92
15%	AIME over $6,002	*15% x $998* = $149.70
Total: Worker's PIA (*rounded down to lower dime*)		**$2,648.00**

Source: Congressional Research Service.

Propose an emergency fund

Employees often take hardship distributions or loans from their 401(k) plans when emergencies arise. This is called leakage. Although they pay back their loans to themselves with interest, they're still depleting their retirement savings.

For employees with direct deposit, you can suggest they divert a flat amount or small percentage into a savings account or money market fund. This is called split depositing.

Upside: Employees will have an immediate and accessible nest egg when an emergency arises.

Downside: Savings accounts don't pay much interest.

Incentives for pretax deductions

Younger employees, who tend to earn less, may not be able to make pretax deductions due to other demands on their pay, like student loans.

You can encourage these employees to contribute something pretax by letting them know about a tax credit they can take on their 1040s. The tax credit rate depends on employees' filing status and adjusted gross income. The maximum credit is $1,000 if employees contribute $2,000 to your 401(k) plan.

The tax credit isn't a piece of cake (no credit is), but it helps employees save toward retirement.

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