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Longview "INSIGHTS" Newsletter

"helping clients grow, protect and distribute their wealth"

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This is a report published by Five Star Wealth Manager Keith Tufte of Longview Wealth Management, LLC with insights on investing and wealth management. This month's investment letter is written by John O'Connor, an associate of mine at Cherry Tree Companies.*

"MOST PEOPLE ARE NOT SAVING ENOUGH FOR RETIREMENT, AND THAT IS A PROBLEM." – KEITH TUFTE

IS YOUR 401K PLAN COMPETITIVE?

What are the current trends in the best retirement plans? How does your plan compare? Are your employees taking full advantage of your plan, and saving enough for their retirement? The passage of the Pension Protection Act of 2006 and subsequent regulatory changes have spurred significant changes in 401K plans over the past two years. Many of these changes are aimed at increasing participation rates, automating the process of getting enrolled, and automating the investment process so that more employees will successfully save enough for retirement. Most are not saving enough now. A competitive 401K plan is a critical tool for attracting and retaining top employees.

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AUTOMATIC ENROLLMENT OF NEW EMPLOYEES – Automatic enrollment for new employees is used in 59% of all 401K plans, up from 34% two years ago. This is the hottest new trend in 401K plans. We are big fans of auto-enrollment for both new and existing employees because it increases the participation rate and helps get people started saving for retirement. People aren't opposed to contributing to the plan, they just never get around to it. It can also help the plan become more balanced (and not top-heavy) which can allow for higher levels of contributions by highly compensated employees (HCE's) who may wish to contribute up to $16,500 per year. The negatives of auto enrollment are that the company may have to contribute more to the plan. The most common automatic enrollment savings rate for employees is 3% of pay. 3% of pay is not saving nearly enough to allow most people to reach a comfortable retirement, but it is better than nothing. The average participation rate in plans with auto enrollment is 86%, 22 percentage points higher than those without auto enrollment.

AUTOMATIC ENROLLMENT OF EXISTING EMPLOYEES – Some companies are also doing an auto enrollment of all existing employees, in an effort to increase participation rates. This is often done every two or three years. This can help get the participation rate in the plan overall to 90%+. Only about 21% of plans automatically enroll existing employees. The most common reason for not doing this was the increased cost of the employer match, and negative employee reaction to deductions being automatically being taken from their paychecks.

AUTOMATIC CONTRIBUTION INCREASES – 59% of plans offer automatic contribution escalation in their 401K plans. They typically increase each employee's contribution rate by 1% per year up to a target of around 7%-10% of pay. These are often used along with auto enrollment.

ROTH 401K – 29% of plans now allow Roth 401K contributions, and another 25% of plans are likely to add them over the next year. These Roth 401K contributions are after-tax. The Roth 401K is a very attractive feature. Roth 401Ks are likely to become more popular thanks to legislation passed in the Senate recently (September 2010), which allows employees to transfer funds directly from traditional 401K plans to Roth 401K accounts, under certain conditions. A Roth 401K conversion is very similar to a Roth IRA conversion, and income taxes must be paid on the converted amounts. 13% of participants made Roth 401K contributions when given the opportunity. Many companies are now offering both the traditional 401K and the Roth 401K in their plan, which allows employees to contribute to one or the other (or a combination of both). A Roth 401K does not have the income limits ($176,000 for married couples) like the Roth IRA, making the Roth 401K attractive for business owners and executives seeking tax-free growth. We have a great deal of expertise in evaluating Roth IRA and Roth 401K conversions.

AUTOMATIC REBALANCING – 54% of plans offer automatic rebalancing. The need for automatic rebalancing has been established, since most participants do not rebalance on their own.

PARTICIPATION RATES – In 2009 participation rates in 401K plans on average were about 74%. The average contribution rate in 2009 was 7.3% of pay by the employees themselves, plus 3.5% by employers, for a total contribution average of around 10% of compensation. We think a 10%-15% savings rate is a good target for most employees if they are able to maintain that throughout their whole career. The average participant 401K balance at the end of 2009 was $70,970. Are your 401K participation and contribution rates this good? If not, why not?

DEFAULT INVESTMENTS – TARGET DATE PORTFOLIOS – 78% of plans offer target date funds in 2010. When available, 51% of participants invested in premixed portfolios, and those who did experienced stronger investment results than those who did not. The most common default investments in 401K plans (used by 72% of plans) are now pre-mixed Target Date Retirement Portfolios. 56% of plans offered the target date funds of their record-keeping firm (conflict of interest?). Some Target Date portfolios have an extra layer of fees associated with them. We think target date portfolios are key to improving participant investment performance. These portfolios give participants the correct risk level, excellent diversification, automatically rebalance, and automatically get more conservative as they get older.

EMPLOYER MATCHING CONTRIBUTIONS – The most common contribution by large companies is 3% if employees save 6% of their salary (Towers Watson Study). This is a match of $.50 per $1.00 of employee contributions up to 6% of salary. Prior to the recession in 2008, 88% of companies provided some sort of match. In 2009, 19% of companies reduced or eliminated their match. Many of those cuts have since been restored.

IMMEDIATE PARTICIPATION – 57% of plans allow for immediate participation in their 401K plan. Only 28.5% of firms required one year of service or longer for matching contributions. Source: Callan Associates 2010 study.

INVESTMENT OPTIONS – The typical plan has 18 funds to choose from. The most common new investment options being added to plans are Inflation Protected Bond Funds (TIPS) and Target Date Funds. Small-cap and mid-cap funds were the most commonly dropped fund types from 401K plans.

COST REVIEWS AND DISCLOSURE – 401K plans are famous for often having high and non-transparent fees. The federal government is leaning on firms to disclose fees and make them clearer. New guidelines on fee disclosure take effect in mid-2011. 84% of plan sponsors have reviewed and calculated the fees of their defined contribution plan within the past year. One way to dramatically reduce the costs in your plan is to increase the mix of low-cost index funds, and to choose lower cost active funds. Another good idea is to bring in outside experts (like us) to compare the cost of your plan every two or three years.

EMPLOYEE EDUCATION – About 50% of companies offer employees some form of guidance from outside advisory firms. About one-third of big companies are going the one-on-one route for advice, something almost no company did a decade ago. Few people, it turns out, are willing to take advice from a computer. In a recent study by Hewett, they found that 95% of workers never used the fancy computer models to help them pick a portfolio.

LONGVIEW WEALTH MANAGEMENT 401K PLANS – We help business owners improve and manage their 401K plans. We are independent of the 401K providers and fund companies, and give objective advice and guidance. We help companies increase the participation and contribution rates in their plans, design plans to maximize tax benefits for the owners/executives, and design custom target date portfolios for our 401K clients. Let us show you how we could help you build a modern and competitive 401K plan for your company.

Sources: Hewitt Associates 2010 Studies. 162 mid-sized and large companies, 5.7 million employees.

Longview Wealth Management, LLC provides unique wealth management services for a select group of client families to give them peace of mind. Longview is run by Keith Tufte, who has over 23 years of successful investment management experience as a Wall Street Analyst, Mutual Fund Portfolio Manager, Director of Equity Research for a major mutual fund firm, Hedge Fund Portfolio Manager, and Wealth Management Advisor. Please FORWARD this e-mail to any friends/relatives/business associates that you think may have an interest. Please visit our website at www.longviewwealth.com.

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