



## Mismanaged 401(k)s Put Many Retirees In Jeopardy

**T**he traditional approach to 401(k) saving has put the retirement future of millions of Americans at risk. Many workers eligible to participate in 401(k)s choose not to make contributions or participate only minimally. Meanwhile, many make poor investment decisions. While recent tax reform legislation has sought to address some of these issues, the national experiment that has changed the way people save for retirement appears not to be working out very well for many Americans.

During the past two decades, there has been a sea change in how people save for retirement. We've shifted from being a nation where retirees depended on traditional defined-benefit pension plans sponsored by their companies to one where retirees are personally responsible for their own retirement savings.

Consider these facts from a recent study by the Center for Retirement Research at Boston College and statistics from the Federal Reserve's Survey of Consumer Finances (SCF):

- In 1983, more than 56% of workers depended solely on a traditional defined-benefit pension plan. Today, fewer than 20% of employees depend solely on a defined-benefit plan.

- In 1983, just 13% of workers depended on a defined-contribution plan, such as a 401(k), as their sole retirement plan. Today, about two-thirds of all workers depend solely on a 401(k) to fund retirement.

The shift during the past two decades

from retirement plans where your benefits are defined to plans where only your contribution is defined has significant implications for Americans. Traditional defined-benefit plans are managed by investment professionals picked by your company, and they typically promise to pay you in one lump sum upon retirement or in payments that are annuitized over your expected life span. With a 401(k) plan, which is a defined contribution plan, you are responsible for picking your investments and there is

no promise from your company to pay you a fixed amount after you retire. The growth of your retirement savings depends on the financial markets and your asset allocation decisions.

The change effectively shifts the responsibility for retirement saving from an employer to an employee. With a 401(k), workers decide whether to sign up, how much to contribute, how to invest retirement funds, and whether to withdraw retirement savings when they change jobs. In every case, according to the Center for Retirement Research study, employees' decisions are less than ideal.

- **Many don't participate.** Between the 2001 and 2004 SCF studies, the proportion of eligible workers who participated in a 401(k) rose from 74% to 79%. In other words, more of those whose companies offer a plan did sign up, a potentially positive development. But because fewer workers overall had the option of participating—possibly because younger companies, responsible for much

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## Oh Happy Day!

**S**ome of you may know that I have been trying to hire an operations manager since last October. We needed someone to manage the staff and client relations as well as implement my projects and vision.

Well, after six months of interviewing, testing, and outright hair pulling, we have found Deborah Bromley. Deb comes to us with an extensive background in operations as well as customer relations and development. We're all extremely excited to have her join us, and we look forward to your enthusiasm as we introduce the many unique and creative programs that she will be helping us implement.

As we move forward to putting these enhancements to our client experience into practice, we are especially eager to bring additional value to our most valuable relationships: you and your family. Deb can be reached at x240 and looks forward to meeting you at our next appointment.

Have a wonderful (and warm) spring,

Marty.



*Martin V. Higgins*

# What's Your Wealth Management IQ?

**E**very year, wealth management gets a little more complex. Congress passes another law, the IRS changes its rules, and financial experts devise new strategies. Consider this quiz a financial reality check; if you're not quite up to speed, we'll be happy to help.

## 1. An irrevocable life insurance trust (ILIT):

- removes life insurance death benefits from your taxable estate
- requires you to give up control and ownership of a life insurance policy
- can be created with an existing life policy
- All of the above

## 2. A properly diversified investment portfolio contains:

- investments customized to your goals, risk tolerance, and time horizon
- a mutual fund tracking performance of the Standard & Poor's 500 or another broad market benchmark
- a 60%/40% mix of stocks and bonds
- alternative investments such as hedge funds and private equity

## 3. The Roth 401(k), which rewards after-tax retirement saving with tax-deferred growth and tax-free withdrawals after age 59½:

- is scheduled to "sunset" with the 2010 expiration of the 2001 tax act
- avoids mandatory withdrawals

after age 70½

c. may be offered by more companies after being made permanent by the Pension Security Act of 2006

d. provides higher after-tax retirement income than a traditional 401(k)

## 4. Tapping a traditional IRA before age 59½ triggers a 10% early withdrawal penalty except when:

- plan distributions are part of a series of "substantially equal periodic payments" set up under rule 72(t) of the tax code
- the money goes to pay college tuition and fees for you, your spouse, your children, or grandchildren
- you use up to \$10,000 (or \$20,000 if married) to help purchase a first home for you, a parent, spouse, child, or grandchild
- Any of the above

## 5. If you leave your job and your retirement account at your former employer is made up mostly of highly appreciated stock in the company, it's often best to consider:

- leaving your money where it is
- rolling over the entire account to an IRA
- taking an immediate distribution of the stock and paying income tax on the shares' original cost because profits will be taxed at capital gains rates
- making a rollover under IRS Code Section 1099-24 to invest in Energy

Futures

## 6. In 2008, which of the following will not be a tax-advantaged way to fund your philanthropic goals?

- Avoiding income tax on required IRA distributions by directing up to \$100,000 to a nonprofit organization
- Making a tax-deductible contribution to a donor-advised fund
- Establishing a private foundation
- Creating a charitable remainder trust that pays income to you now and benefits charity when you die

## 7. Most retirees won't need long-term care insurance, which covers nursing home care, because:

- Medicare, which covers everyone age 65 and older, pays for extended care at a nursing home
- only one in 10 seniors ever needs long-term care.
- the cost of a nursing home is rising at less than the overall inflation rate
- None of the above

## 8. Naming a corporate trustee for a trust rather than a friend may make sense because corporate trustees:

- are more sensitive to beneficiaries
- have experience in safeguarding assets, record keeping, and rules governing trusts
- offer lower fees
- None of the above. ●

Answers: 1d; 2a; 3c; 4d; 5c; 6a; 7d; 8b

## When Your Financial Advisor Accepts The Role Of Fiduciary,

**I**n the world of financial advisors there are myriad labels, certifications, registrations, and other terms that tend to be meaningful only to industry insiders. But one distinction could be crucial: An advisor bound by contract or law to serve as a "fiduciary" is obligated to act solely in your best interest. That's different from others who may seem to work for you but in fact owe primary allegiance to the companies that pay them.

With other professionals, such as lawyers and CPAs, there's typically a fiduciary responsibility that requires them to act in clients' best interests.

But for financial advisors, fiduciary status is not yet standardized or guaranteed. So while you may think your stockbroker offers unbiased advice, he or she is probably receiving a commission for selling you products. To complicate matters, even a fee-based advisor who charges for advice may not be acting solely in your interest.

Not surprisingly, there's widespread confusion among consumers on this point. According to a recent survey by a major financial services firm:

● More than half of the investors interviewed believed both stockbrokers and Registered Investment Advisors

(RIAs) have an obligation to act in the client's best interests.

● Three out of four investors didn't realize that only independent RIAs have a fiduciary duty to their clients.

RIAs must inform clients of potential conflicts of interest, and they're legally obligated to act as a fiduciary. They have a fiduciary duty to act in their clients' interest at all times. Stockbrokers don't have the same obligation. Brokers must make recommendations that are suitable but are not required to adhere to the higher standard of care—to always do what's in your best interest—as a fiduciary.

# Coordinating A Couple's Retirement Plans

**B**ack in the days of Ozzie and Harriet, retirement decisions were simple: the husband's retirement plans were the couple's retirement plans. Today, you and your spouse may both work, and retirement timing and coordination is a challenge. While leaving the work force at more or less the same time may seem ideal, issues of age, health, job satisfaction, and pension and other employment benefits can make that tough to pull off.

For most couples, joint retirement decisions mean weighing the benefits of having more leisure time to spend with each other against the cost of one or both of you leaving work. That can be difficult to gauge, particularly when spouses are different ages, work for different employers, and face conflicting retirement incentives. Richard W. Johnson, a researcher for the Center for Retirement Research at Boston College, cites the example of a couple in which the husband has a company-sponsored retirement plan that lets him retire at age 62.

His wife is three years younger, and the retirement age in her employer's plan is 65. For the husband, retiring at 62 may be financially beneficial. Yet by the same token, if the wife waits until her financially optimum retirement date, she could end up working six years longer than

spouses is thinking about retiring before age 65, when Medicare coverage begins. For example, consider what would happen if our couple went ahead and retired when he was 62 and she was 59. Assuming both had health coverage at work but neither had retiree



health benefits—an increasingly common situation, according to Johnson—for three years, until the husband reached Medicare age, they would both need to buy private, non-group insurance. That tends to be prohibitively expensive, and she would continue to need coverage for an additional three years after her husband qualified

her husband, giving away a substantial portion of the time they could have spent together during retirement.

Health insurance coverage may be another sticking point, particularly when one or both

for Medicare. They would be much better off financially if she kept her job and benefits.

There are also questions of job satisfaction and health. Many people today choose to keep working past normal retirement age, at least in part because they enjoy what they do. Yet when both spouses have jobs, one may love going to work every day while the other is counting the days until retirement. Meanwhile, health problems may force the issue, pushing a spouse into retirement regardless of financial consequences.

Still, despite all of these issues, in about half of all couples, both spouses manage to retire within two years of each other, according to Johnson's calculations, and for two-thirds of couples, it happens within four years. Give us a call if you and your spouse would like to review your retirement plans and make sure you're on track to retire on your own terms. ●

## You Have A Foundation For Trust

The distinction between an advisor who is a fiduciary and one who is not could be critical when weighing an advisor's recommendations. There may be a hidden agenda—for example, if an advisor is receiving better commissions for selling you one mutual fund instead of another.

Rules recently clarified by the Securities & Exchange Commission permit brokers to give you investment advice on a fee basis and not act as a fiduciary. In these instances, a broker can only give you advice about one or two issues—such as your retirement plan or investing. If a broker wishes to give you comprehensive financial

advice that spans insurance, taxation, college planning and estate planning as well as investing and retirement planning, the broker must accept his or her role as a fiduciary to you. He must disclose that he will begin giving you advice as a fiduciary and then tell you when he has stopped acting as a fiduciary and reverted back to his role as your stockbroker.

Working with someone who is a fiduciary, or will sign an agreement to act as a fiduciary, doesn't guarantee you'll profit from the advisor's recommendations. But it does give you a greater assurance that you're both sitting on the same side of the table. ●

# Ideas To Help Control Your Spending

**T**he wealthiest 20% of U.S. households in 2004 spent an average of \$876 on alcoholic beverages, more than three times what they spent on reading materials. They spent an average of \$210 on sweets, \$295 on fresh fruit, \$4,669 on eating out, and \$1,460 for telephone service, according to the latest data from the U.S. Bureau of Labor Statistics.

How do your spending habits compare? It's a good question to ask, particularly now, with interest rates going up, inflation still on the rise, and the cost of living getting more expensive – the Consumer Price Index was 3.4% higher at year-end 2005, compared with one year earlier. Even people with high incomes can have trouble budgeting in the wake of these factors and seek ways to slice their spending. The more you have, the more you tend to spend, unless you watch your purchasing habits and create a plan for saving. Here are some ideas for curbing your spending:

**Find the gap.** There's just no substitute for tracking expenses. Take a pad and pencil, or if you're more technologically inclined, use your Blackberry, and mark down what you

spend and when you spend it. Two or three months of data may give you a rude awakening about where you're spending too much. You'll know precisely where you need to lighten up.

**Envelope trick.** For necessities such as food and supplies, and for regular discretionary spending on things such as going to the movies or dining out, put a budgeted amount of cash in an envelope at the beginning of each week. Label envelopes for all your major spending categories.

**Pass up plastic.** Only use your credit card when you absolutely must. It's easier to manage money on a cash budget.

**Kill clutter.** Do you belong to a club you rarely visit, or pay for cable TV you seldom watch? It's easy to get trapped into paying for things you don't need. For instance, some people pay thousands annually to keep their boats docked and ready to go. But they're too busy to actually get out on the water.

**Make yourself happy.** Maybe it's taking your mother on vacation, or putting in a hot tub. Planning to use your money for something that will make you happy can help curb the urge to splurge on less satisfying purchases. ●

## How Do You Stack Up?

Total Income	\$132,158
After-Tax Income	\$124,698
Average Age	47.4
Meat, Poultry, Fish, & Eggs	\$1,252
Dairy Products	\$555
Food At Home	\$4,984
Fruits And Vegetables	\$853
Alcoholic Beverages	\$876
Food Total \$9,653	\$9,653
Housing	\$25,424
Property Tax	\$3,030
Electricity	\$1,512
Utilities	\$4,301
Laundry and Cleaning Supplies	\$209
Postage and Stationery	\$283
Mens and Boys Apparel	\$877
Womens and girls apparel	\$1,466
Footwear	\$558
Total apparel	\$3,654
Transportation	\$14,580
Public Transportation	\$1,153
Health Insurance	\$1,864
Medical Services	\$1,181
Pets, toys, playground equipment	\$710
Total Entertainment	\$4,484
Reading	\$256

Here are income and selected spending categories for households in the top income quintile in 2004. Compare the percentage of your after-tax income you spend on the same items.

Source: U.S. Bureau of Labor Statistics

## Mismanaged 401(k)s

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of the expansion in employment, may not initially offer this benefit—401(k) participation as a percentage of the overall work force remained stuck at just under 40%.

● **Contributions are inadequate.** In 2004, just 11% of all surveyed 401(k) participants were putting away the maximum amount allowed by law.

● **Portfolios aren't diversified.** Fewer than half of participants had a well-diversified portfolio in the 2004 survey. More than 20% had virtually all of their savings in stocks, while a third held no equities and many had an excessive concentration in potentially volatile company stock.

● **Too many cash out of their plans.**

The Center for Retirement Research estimates that in 2004, almost half of employees who changed jobs withdrew an average of 18% of 401(k) assets.

As a result of these mistakes, many workers are approaching retirement with nest eggs that are too small to support anything approaching their pre-retirement lifestyle. According to the SCF, the median retirement plan balance for heads of household aged 55 to 64 was \$60,000—enough to provide an annuity during retirement of only \$400 a month.

It wasn't the most ballyhooed provision of the Pension Protection Act of 2006, which became law August 17, 2006, but the act's shift toward automatic enrollment and investment in 401(k) plans could, in the long run, be significant.

Now, instead of waiting for employees to sign up for a 401(k), companies will be able to enroll them automatically unless workers decide to opt out. According to the nonprofit Employee Benefit Research Institute, that change alone could boost participation from the EBRI's estimate of 66% to 92%. The law also lets companies automatically boost employees' contributions when earnings increase and automatically diversify holdings.

Still, the data coming out of recent studies sends a scary message to Americans: if you are eligible for a 401(k), then invest the maximum amount allowed and invest it carefully. If you are unsure about whether you are making the right 401(k) decisions, call our office and we'll do our best to answer your questions. ●