Briefly Noted

If Your 401(k) Could Talk…

If your retirement plan could talk, what would it say? Actuarial consultant Milliman imagines it would bring up 10 important points.

1. **Save More.** Citing data from Fidelity showing an average account balance of $75,900, Milliman says employees are not saving enough for retirement.
2. **Figure Out How Much You Need for Retirement.** Nearly 60% of those who have used a calculator to estimate required retirement savings say they save more as a result.
3. **Know What You Are Paying in Fees.** Review what you are paying in fees regularly and take actions to reduce them when possible.
4. **Diversify.** If too much of your savings is in one place, your account could be hit hard by losses in one investment, so diversify across different assets.
5. **Take Advantage of Compounding.** Compounded returns can have a dramatic impact on your wealth by allowing you to earn profits on both your contributions and your investment gains.
6. **401(k) Loans Are a Double-Edged Sword.** When you borrow from a 401(k) plan, you are paying yourself back on an aftertax basis. When you retire and take distributions, you will pay taxes on that amount again.
7. **You May Not Be Entitled to Your Entire Account Balance.** If your employer has a vesting period for contribution matches and you leave your job, you may forfeit the amount that has not fully vested.
8. **401(k) Accounts Are Portable.** When you leave a job, you can roll your old 401(k) plan to your new employer's 401(k) plan or, if you prefer, to an individual retirement account.
9. **Tax Reform Could Affect Your 401(k) Plan.** Congress could look to reduce or eliminate deductible contributions to retirement plans as part of a deficit reduction strategy. Congress did this before, in 1986.
10. **Buy Shares in Bulk.** By combining employee contributions together, some 401(k) plans may be able to negotiate lower fund fees than would otherwise be available to you.

Source: "Ten Things Your 401(k) Wants You to Know," Jinnie Regli, Milliman Insight, January 21, 2013.

Big Ad Spending Not Influencing Retirement Savings Behavior

Americans remain unprepared for retirement, even though the financial services industry spent $1.14 billion in 2011 advertising retirement planning products and services. To determine why the promotional messages are not changing behaviors, the Deloitte Center for Financial Services surveyed 4,500 consumers from a wide range of age and income groups. What they found were five barriers restricting Americans from taking a more disciplined approach.

Those barriers are:

1. **Conflicting Priorities.** About 40% of those surveyed said other financial priorities (e.g., mortgage, student loans, etc.) interfere with their ability to save for retirement. Health care expenses are a bigger factor for older adults, with 41% of retired respondents saying that saving for medical expenses is a priority.
2. **A Failure to Communicate.** Six out of 10 respondents said they have not discussed their retirement savings and income needs with any financial institution during the past two years. The lack of communication does have an income element, with the instances of being contacted by financial professionals rising for those with salaries in excess of $200,000 per year.
3. **A Lack of Product Awareness.** Deloitte found that many individuals were not familiar with the savings products available to them. For instance, 60% don't know anything about target date funds or are unsure how these funds work. Four out of 10 respondents don't understand how annuities work.
4. **Mistrust in Financial Institutions and Intermediaries.** Less than one in five respondents said they have a high degree of trust in any type of financial institution. Less than one in 10 thought the ads run by financial institutions were highly trustworthy.
5. **"Do It Myself" Mentality.** Nearly 60% of respondents said they were more comfortable handling their retirement plan on their own, rather than consulting with a financial professional.

The report was written for the financial services industry, but we think it offers some lessons for individuals as well. The biggest issue is that many individuals are simply not taking the time to create a comprehensive financial plan and investigate the investment options available to them. Even if a plan is not fully executable, it creates a roadmap to help guide future spending, saving and investing behavior. Plus, such a plan can provide a framework for judging the suitability of various investment products.

Source: "Meeting the Retirement Challenge: New Approaches and Solutions for the Financial Services Industry," Deloitte Center for Financial Services, 2013.

A Lack of Openness Between Advisers and Investors

A report from analytics firm Cerulli Associates revealed differences in how investors and financial advisers perceive their financial relationship. Investors either misunderstand or don't understand how their advisers are being compensated. Advisers, on the other hand, often control a smaller portion of their client's portfolio than they otherwise believe.

On the subject of compensation, Cerulli reported, "Overall, more than 60% of investor households believe they are receiving fair value from their advice providers, though nearly two-thirds of investors either believe the advice they receive is free, or do not understand how their providers are paid. In many cases, advisers and providers fear what the reactions of clients would be if they understood how an adviser was being paid, essentially doubting their own value. By embedding fees within portfolio management costs or deducting revenues from accounts, providers are able to avoid the perceived pain-point of having investors write discrete checks to pay for the services they receive. However, in reality, if the client does not understand what they are paying, they are more likely to assume it excessive."

Advisers, conversely, either misconstrue or are in the dark about how much of their client's assets they actually oversee. Again from Cerulli, "Overall, 74% of investors report owning a direct investing account in addition to their primary provider relationship; however, advisers believe that just 17% of their clients hold these accounts. This discrepancy clearly underscores the difference between reality and advisers' perceptions of their relationship with clients. The goal of traditional advisers is to manage the entirety of their clients' portfolios, but the majority of investors prefer to keep at least a portion of their assets a secret from their advisers."

Clearly, the report's findings show a large communication gap between advisers and their clients. Blame for the misunderstandings is shared by both sides. Advisers are reluctant to discuss how they are compensated and investors are reluctant to reveal their entire financial picture.

For an adviser-client relationship to work properly, both parties must be upfront and open. The responsibility for this openness lies primarily on the individual investors who both must give their advisers enough information to receive proper advice and need to understand how and what they are paying in return for the adviser's services.

Source: "Cerulli Finds More Than 60% of Investors Don't Know How Their Providers Are Paid," Cerulli Associates, February 26, 2013.

Proposals to Reform Money Market Funds

Three proposals to reform money market funds were the subject of a letter from the presidents of 12 Federal Reserve banks to the Financial Stability Oversight Council.

The first proposal would allow net asset value (NAV) to float. Currently, money market funds are priced at $1 dollar per share. This price is held steady, even though the value of the underlying assets fluctuates on a daily basis (the amount of change is usually very small). The advantage of a floating NAV is that all purchases into and withdrawals from a fund by shareholders are conducted at prices that match the current valuation. In the event of a crisis, this would prevent a money market fund from being forced to buy back shares worth less than $1 at $1 per share—a situation that gives a potential advantage to those who sell their shares first. The downside is that under normal circumstances, any shareholder could find themselves receiving less than $1 per share when they need to withdraw cash.

A second proposal would create a 3% NAV buffer. This buffer would allow the fund to absorb small fluctuations in its net asset value, while maintaining the $1 per share value. However, the Federal Reserve Bank presidents noted that this proposal could lead to reduced yields and provide a benefit to first movers who foresee a breaking of the buffer and move to sell their shares first. (Under such scenarios, remaining shareholders face the threat of absorbing the fund's losses.)

A third option would be to combine the NAV buffer with a minimum balance at risk (MBR). Under this proposal, when a full withdrawal is requested, a portion of the funds would be held back for 30 days. The Federal Reserve Bank presidents note that this may not prevent a run on money market funds from occurring, either.

It is important to note that these are just comments on proposals. It continues to remain uncertain what, if any, new reforms on money market funds will be implemented, especially since the fund industry has pushed back against the proposed changes.

Source: "All Twelve Federal Reserve Bank Presidents Support Money Market Mutual Fund Reform in Joint Letter to the Financial Stability Oversight Council," Boston Federal Reserve, February 12, 2013.