Briefly Noted

Adjust Savings Rates as Income Rises

An adjustable approach to retirement savings may improve the odds of success. Researchers at Dimensional Fund Advisors suggest workers adjust their savings rate as their income increases over the span of their careers.

A worker who consistently saves from age 25 until retirement at age 66 will need to put away 16.8% of his salary annually to replace 40% of his preretirement income with a 95% probability. Their suggested savings rates include employer contributions. The portfolio allocation used is a mix of global equities and fixed income. The allocation is adjusted annually based on the exposure to stocks equaling 120 minus the worker's age.

Changes in age or the savings rate alter the equation. A worker who starts at age 30 will need to save 19.5% of his income, while a worker who starts at age 35 will need to save 23.8% of his salary to achieve a 95% probability of having enough to adequately replace his income in retirement. A 35-year old who saves 19.2% of his income instead will see the probability of having enough in retirement decline to 90%. At an 8.7% savings rate, the probability of success falls to 50%.

Changes in income also alter the outcome. The researchers calculated the highest failure rates of not meeting the target income replacement rate among households with steep income growth. This necessitates a change in savings rates as income rises. For example, a 25-year-old making $48,000 can start by saving 6.6% of his salary. When he reaches a peak income of $120,000 by age 45, he should save 17.6% of his salary. Doing so will give him a 90% rate of success.

Across income levels, savings rates for a 90% chance of success range from 4.4% for those earning between $25,000 and $40,000 to 11.0% for those earnings between $60,000 and $70,000 to 26.4% for those earning in excess of $180,000 per year. The rates for a 95% probability of success are 5.7%, 14.2% and 34.0%, respectively. These are not static levels, but rather suggested ranges workers should adjust their savings rates to as their incomes rise over time.

As far as determining whether savings are on track, the researchers suggest dividing accumulated assets by current income. An asset/income multiple of 7.5 at age 55 implies a 90% success of having enough savings to replace 40% of income in retirement, excluding the additional amount provided by Social Security benefits.

Source: "How Much Should I Save for Retirement," Massi De Santis and Marlena Lee, Dimensional Fund Advisors, June 2013.

More Stocks, Fewer Options Awarded

More companies are awarding full-value shares of stock instead of options and are linking executive compensation to the achievement of specific goals. Equilar, an executive compensation data firm, says an increase in the trend has occurred, as this year's proxy season is the third during which "Say on Pay" proposals are appearing.

The number of S&P 1500 index companies awarding stock options only (as opposed to stocks and options) to their employees declined to 5.0% in 2012 from 16.2% in 2007. At the same time, 32.6% of companies gave only restricted stock awards in 2012 versus 17.8% in 2007.

The percentage of S&P 1500 companies granting options fell to 65.2% last year, from 78.5% in 2007. The median number of stock options granted declined to 578,000, continuing a downward trend seen before 2007. At the same time, the proportion of companies granting restricted shares of stock reached 92.8% last year, versus 80.1% in 2007. A median 1.13 million restricted shares were outstanding last year compared to a median 617,000 in 2007.

Utilities were the largest granters of options, awarding a median of 1.04 million last year. Coming in a close second were health care companies, with a median 981,000 option grants awarded. Nearly three-quarters of health care companies gave both stock options and restricted stock, the largest proportion of any sector. Health care company options most commonly came with a five-year cliff vesting period, meaning the contracts could be not exercised for five years.

Equilar also conducted an analysis of chief executive officer (CEO) awards by taking an early look at proxies from 477 S&P 1500 companies with fiscal-2012 information. The number of companies granting performance-based equity grants to CEOs increased from 50.1% of companies in 2010 to 61.8% in 2012. Approximately 66.2% of these performance equity vehicles were pared with a long-term performance period. Four out of 10 performance equity vehicles were long-term incentive units, which are typically converted into cash or stock at the time of payout.

Source: "2013 Equity Trends Report," Equilar (www.equilar.com).

Prenuptial Agreements May Not Waive Beneficiary Rights

The mere inclusion of a clause in a prenuptial agreement to waive beneficiary rights to a 401(k) plan's proceeds is not enough to enact an actual spousal waiver. Rather, a spouse's rights are only waived if the consent requirements in the Employee Retirement Income Security Act of 1974 (ERISA) are complied with. This was the recent finding of a federal appellate court.

At issue was whether a deceased man's then-wife or his parents were entitled to his 401(k) benefits. Michael G. Cox II and Kathy L. Cox executed a prenuptial agreement on February 19, 2010, before getting married on March 6, 2010. Michael filed for a divorce on May 4, 2011, but died on May 21, 2011, before the divorce was finalized. His 401(k) plan, the MidAmerican Energy Corporation (MEC) 401(k) plan, asked Kathy on August 2, 2011, to sign a waiver disavowing any rights to receive Michael's retirement savings. Kathy refused and the case was taken to court.

In upholding a lower court's ruling in favor of Kathy instead of Michael's parents, the 8th U.S. Circuit Court of Appeals opined, "For Michael's designation to control, Kathy must have waived her rights in accordance with Section 1055(c)(2)(A)" of ERISA. The court concluded Kathy did not explicitly do so.

In explaining its rationale, the appellate court said "The antenuptial agreement is equivocal whether Kathy waived her rights at all." Even though the prenuptial agreement included a pledge by both spouses to waive their rights to the other's retirement plans, no additional action was specifically taken to execute Kathy's waiver. As such, the court concluded, "In the absence of the fulfillment of this promise, Kathy could not have meaningfully acknowledged the effect of any waiver of her spousal rights in the antenuptial agreement."

The key issue was that though Kathy agreed to waive her rights in principle, she never signed any notarized documents directly instructing the MEC 401(k) plan that she was waiving her rights. The case shows the importance of ensuring all beneficiary information is properly checked and updated on a regular basis, especially if a significant change in family status occurs.

Source: MidAmerican Pension and Employee Benefits Plans Administrative Committee v. Michael G. Cox, Sr., Joleen Cox and Kathy L. Cox, U.S. Court of Appeals for the 8th Circuit, July 12, 2013.

Dementia and Financial Decision Making

The impact of a memory disease diagnosis on a couple's finances depends on how actively the couple controls their retirement accounts. Couples who manage their own retirement accounts are 2.4 times more likely to change the spouse in charge of handling their finances when a medical diagnosis of cognitive impairment is given. This is the finding of Federal Reserve economist Joanne Hsu and University of Michigan professor Robert Willis.

A reason for this is that couples who control their investment choices are potentially more exposed to poor financial decisions. As such, they face greater benefits and are more likely to make a change in reaction to an increased awareness of cognitive impairment.

However, the study's authors found that the probability of switching the financial respondent is less dependent on the financial decision-maker being "cognitively impaired but not demented" (CIND) then it is on the probability of reporting problems with managing money. The decision to turn over finances to one's spouse often occurs after people develop difficulties managing money. Hsu and Willis based these conclusions on data included in the ongoing Health and Retirement Study (HRS) and on supplementary data included in the Aging, Demographics, and Memory Study (ADAMS).

No difficulties in managing money were reported by the financial decision-makers until their cognition scores reached the CIND range. Once the scores reached the CIND range, the proportion declined linearly to about 20% to 60% reporting no difficulties in the dementia range of scores. The authors believe this suggests that many cognitively impaired respondents were either not aware of the problems they have managing money or were not willing to tell an interviewer about their problems. Notably, the data revealed that even among respondents with cognitive scores in the dementia range, only 25% reported a memory disease diagnosis.

Though individuals were less likely to be the financial decision-maker as cognition scores declined, over 80% of the baseline financial decision-makers continued to manage their finances even with scores in the demented range. Hsu and Willis theorize that one possible reason could be the presence of a spouse with even worse cognitive impairment.

Source: "Dementia Risk and Financial Decision Making by Older Households: The Impact of Information," by Joanne W. Hsu and Robert J. Willis, Federal Reserve Board, April 1, 2013.