

Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND
FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

Automatic Contribution Escalation The Next Step Toward Retirement Income Adequacy



What is the purpose of your retirement plan? Ponder it. If you responded, “To reward long term employees” or, “To help employees save for retirement,” we suggest you rethink this important topic. If the purpose is to reward long term employees, you can simply provide a cash bonus. Thought about differently, isn’t your healthcare program designed to maintain or improve the health of your employees? Your retirement plan is only successful if it provides for a *meaningful* retirement. Merely having a retirement plan, or making company matching contributions, or even using automatic enrollment is no longer enough. We challenge you to consider your retirement plan as an employee’s most important tool toward having a *meaningful* retirement. Aside from a home, for most Americans their single largest asset is their retirement account. It’s not uncommon for a participant to amass a retirement account value of a few hundred thousand dollars by systematically contributing over their career, even as a modest wage earner. The question at the end of the day, or more directly, at the end of one’s career is, “Did you save a *meaningful* amount?” Tragically for many Americans, they have not. What should plan sponsors do about this?

The answer comes in two parts. First, plan sponsors should design plans with features that result in *Retirement Income Adequacy*. Successfully accumulated accounts can support systematic withdrawals of approximately 5% per year and combine with Social Security to provide a preretirement income replacement level of at least 80%. Taking Social Security into consideration, **is your plan reducing the gap?** Many vendors have the ability to provide a telling calculation. The most important factor to achieve this meaningful level of accumulation is the contribution. “Maintaining a similar standard of living during retirement requires an estimated savings rate of 11% to 15% of income *over the course of a working career*,” according to the Principal Financial Group’s 2011 study titled, “Our View on Retirement Readiness: How to Move from a ‘Popular’ Plan to a Successful Plan.” Too often, participants are told to “max

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Q1 2013 Market Review

With the fiscal cliff over, U.S. equity markets moved higher over the quarter. Not only did they advance at a fairly brisk pace, but they finished the quarter at all-time highs. The approaching debt ceiling and sequester, consisting of budget cuts to be implemented gradually across many government agencies, did little to slow the U.S. equity markets. For the quarter, U.S. equity finished up 11.1% (Russell 3000 Index). International equity markets lagged their U.S. counterparts, returning 5.2% for the quarter (MSCI EAFE Index). Fixed income markets failed to achieve a positive return, as interest rates ticked higher. Most fixed income sectors, except for the most risky, were negative. For the quarter, the U.S. fixed income market posted a negative 0.1% (Barclays U.S. Aggregate Index).

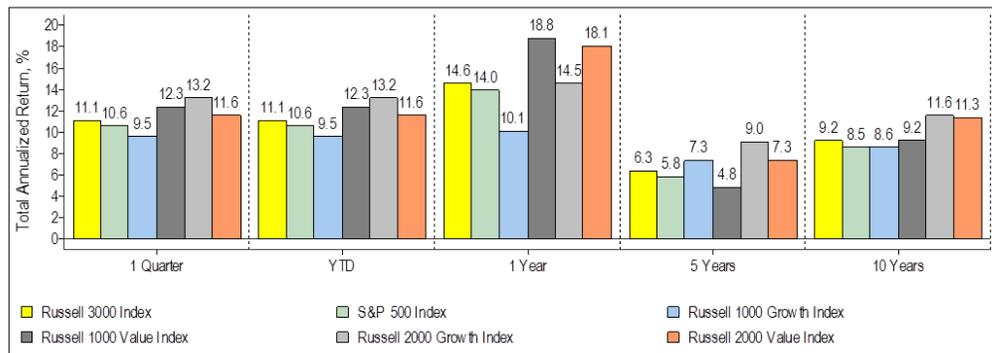
Reversing the trend in 2012, the first quarter of 2013 saw net new positive cash inflows into equity mutual funds. Investors became comfortable with equity markets, likely noticing the strong double digit returns posted in 2012. With rising equity markets, interest rates also began to rise over the quarter. As measured by the 10-year Treasury bond yield, rates went from 1.76% at year end to 1.85% by quarter end. Over the quarter the 10-year Treasury bond hit a high

of 2.09%, a level not seen in over a year. The rise in rates over the quarter was enough to hold fixed income performance back, but not cash flows into bond funds. Much like 2012, bond mutual funds continued to garner net new positive cash flows, outpacing their equity mutual fund counterparts.

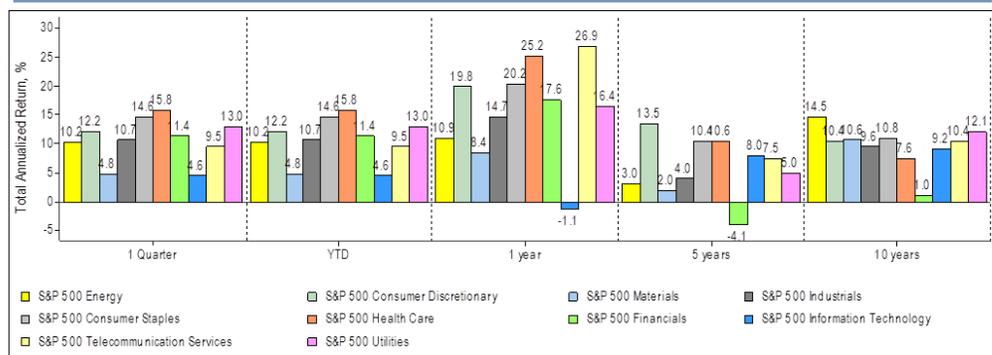
Central banks around the world continue to supply the global capital markets with liquidity through their easy monetary policies. The latest entrant to the party was Japan, which indicated they would pump approximately \$1.4 trillion into their economy in less than two years. This would effectively double Japan's monetary base to 270 trillion yen, or approximately 2.9 trillion dollars. This probably helped propel Japan's equity markets to double digit gains over the quarter. Recent issues surrounding Cyprus, a small eurozone country, suggest that eurozone issues have not gone away. Prolonged easy monetary policy in and of itself is a risk. Just a year ago the Fed weighed in on whether to apply further stimulus (eventually giving way to more in 2012). While there may be no question today that further stimulus will continue, the question of when it will stop is in the not too distant future. ●

U.S. Equity Index Performance

- All U.S. equity styles posted strong returns for the quarter
- Small growth was the best performing style:
 - Up 13.2% for the quarter
- Large growth was the worst performing style:
 - Up 9.5% for the quarter
- Best performing sectors for the quarter:
 - Health Care, up 15.8%
 - Consumer Staples, up 14.6%
- Worst performing sectors for the quarter:
 - Information Technology, up 4.6%
 - Materials, up 4.8%



U.S. Equity Sector Performance





Women and Retirement

Unique circumstances make saving for retirement a challenge for women. On average, not only are women earning less than men, but they're living longer as well. Also affecting their ability to save are gaps in employment many women experience while raising children or caring for aging parents. With the odds stacked against them, it's no wonder many women find saving for retirement overwhelming or even impossible.

In actuality, women possess inherent qualities that prove advantageous when it comes to the topic of retirement. They are natural planners and savers. In fact despite earning less, women save a greater percentage of their income. Women also tend to invest in a target date fund (TDF) resulting in minimizing their overall risk. (Note – In a TDF, the target date is the approximate date when investors plan to withdraw money. The principal value of the TDFs is not guaranteed at any time, including at the target date. Since the fund objectives change over time, the investment objectives and strategies will change to become more conservative as the target date approaches.)

Consider adopting features (automatic enrollment/escalation, company match, etc.) in your plan to help your women participants become retirement ready. This issue's participant piece addresses this important topic. ●

Auto Escalation Results

The Employee Benefit Research Institute (EBRI) studied the impact of auto enrollment and auto escalation and how these two plan features can positively impact *Retirement Income Adequacy*. The EBRI used a database that included *individual information* on:

- Over 24 million 401(k) participants, in
- Over 54,000 401(k) plans, holding
- Over \$1 trillion in assets.

They defined *success* as “a situation that produces a combined real replacement rate from Social Security and 401(k) projected balances of at least 80 percent.” They separated the results of those in the lowest and highest paid quartiles, to illustrate the differences. Social Security benefits typically represent a higher percentage of income replacement to lower wage earners than what it offers to higher wage earners.

The results showed very similar findings for the two pay groups when auto enrollment and escalation were implemented:

- Low pay quartile – probability of success jumped from 46% to 79%.
- High pay quartile – probability of success jumped from 27% to 64%.
- While the results were based on getting to a 15% deferral, they improved with each step (from 6% to 9% to 12% to 15%.)
- The impact of 1% versus 2% increases varied at different deferral rates, but generally moved in the same direction.

Most providers offer auto escalation, even if it's not the plan's default feature. According to the Principal Financial Group's 2011 Retirement Readiness Survey, only about 6% of participants will sign up for it on their own, but if introduced as a plan default, 80% will allow the escalation. In the end, the “auto” feature overcomes participant inertia and is an important step towards achieving *Retirement Income Adequacy*. ●

Escalation

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out” the company match. This means that they are encouraged to defer at a level sufficient to receive the maximum company match and then upon doing so, the encouragement (to contribute more or at a higher level) ceases. According to Principal, participants confuse the difference between “maxing out the match” with “maxing out their savings.”

Second, how do you encourage participants to contribute meaningful amounts for retirement? The answer is simple. Do for your participants what they won't do for themselves. Just as automatic enrollment solved participant enrollment procrastination, so does automatic

escalation address contribution increase complacency. Automatic escalation is a plan design feature that systematically increases deferrals. In a typical setup, every participant is notified of the intent to increase deferrals by 1% (for example) each year until the contribution reaches a gap (e.g. 10%). In this manner, the increase is gradual and if done at the time of a merit increase, can have little impact on take home pay. Similar to automatic enrollment, participants must receive advanced notice and retain the ability to opt out.

What is the purpose of your 401(k) plan? How do you and your committee define its success?

COMMUNICATION CORNER: Women and Retirement

This month's sample employee memo is titled, "Women and Retirement". An important and interesting subject, this memo covers the unique challenges women face while building their retirement plans.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ (fiduciarybriefcase.com) in both English and Spanish versions.

Call or email your Plan Consultant if you have questions or need assistance. ●

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