Kamp Consulting Solutions, LLC

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Fireside Chat

Your Monthly Update from KCS

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Papa, Can You Hear Me?

We're not flashing back to 30 years ago when the movie *Yentl* graced theatre screens around the world. Instead, one of my children called me recently with questions relating to his new employer's 401(k) plan. My son is a bright young man who graduated from Boston College with a Math major and an Economics minor. Furthermore, he is employed in the financial services industry and holds various certifications.

His questions were thoughtful and likely more advanced than the average young, newly-employed worker. However, it got me thinking about how an untrained employee, college-educated or not, would possibly handle the responsibility of determining one's financial needs 40 to 50 years down the road, discounted at today's value. In fact, I think that this task is difficult for anyone as they wind their way through their careers. Their ultimate objective to achieve a retirement with the appropriate resources to enjoy a fruitful post-employment life may be beyond their ability.

Ostrich-like Behavior?

In the August 2013 *Fireside Chat*, we highlighted some distressing statistics about our nation's retirement readiness. While each of the Employee Benefits Research Institute's (EBRI) survey questions got me thinking, the one that disturbed me the most was the following: "Sixty-six percent of workers report they and/or their spouse have saved for retirement, although a sizeable percentage of workers report that they have virtually no savings or investments." Alarmingly, among the Retirement Confidence Survey respondents, 28 percent say that they have **less than $1,000 saved**. In total, 57 percent report that the total value of their household's savings and investments, excluding the value of their primary home and any defined benefit plans, is less than $25,000. Oh, my!

It is certainly disturbing that only 2/3 of workers surveyed are currently saving, but as we've reported, less than 20% of employees in the private sector are in a defined benefit plan and less than 50% of private sector employers offer a defined contribution plan. Not having access to an employer-sponsored plan may be the single largest contributor to the lack of savings for retirement among the 1/3 of respondents that have reported that they haven't begun to save.

Ostrich-like Behavior? (cont'd)

Overcoming this obstacle may be challenging, but it needs to happen. Exacerbating this situation is the fact that we still have significant unemployment in the U.S., with more than 20 million Americans out of the labor force. Unemployment for those age 25 and less is quite high, and this trend delays retirement funding for our youthful employees when they would benefit tremendously from an early start.

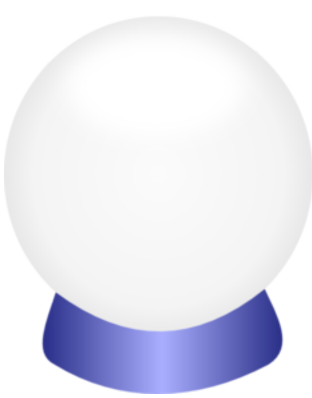
How'd We Get Here?

> *"The defined contribution plan was initially conceived as a supplemental form of retirement income for high wage earners. It was never intended to be the primary source of retirement income for anyone."*

The Revenue Act of 1978 created qualified deferred compensation plans (sec. 401(k)) where participants are not taxed on the portion of income they elect to receive as deferred compensation rather than direct cash payments. The Act created simplified employee pensions (SEPs) and changed IRA rules, and has led to the slow demise of defined benefit plans. The act has placed the burden of retirement funding squarely on the shoulders of most individuals.

Unfortunately, many, if not most, American workers lack the training, skill and confidence to manage this newfound responsibility. The defined contribution plan was initially conceived as a supplemental form of retirement income for high wage earners. It was never intended to be the primary source of retirement income for anyone. Regrettably, it has become such. Furthermore, as defined benefit plans have been frozen or terminated, confidence among American workers in their ability to retire has been shaken. Just 13% of survey respondents are very confident that they will have enough money to live comfortably in retirement. More than ½ of survey responders are not confident at all or not too confident in their ability to amass a retirement nest egg.

How's your Crystal Ball?



Given that most people's crystal ball is fairly foggy, looking into one isn't going to project how much one is likely to need to amass for retirement or what they should invest in to accumulate the desired windfall. Given this fact, how should one begin the process of determining their long-term retirement needs? What are the key elements that one needs to consider when attempting to determine a total pool of assets that will suffice to meet one's annual needs?

Target setting remains an elusive objective. According to recent EBRI information, fewer than half of workers (46%) report that they and/or their spouse have tried to calculate their retirement needs. Unfortunately, that number is lower than it was in the 2000 survey, which had 53% of workers attempting to calculate their financial needs for retirement. So, what can we do to assist in this process? Many, if not most, employers are providing their employees with access to education. Regrettably, only 23% of workers (28% of retirees) report that they have obtained investment advice from professional financial advisors who were paid through fees or commissions. Twenty three percent! Ironically,

How's Your Crystal Ball? (cont'd)

among those 23% seeking advice, only 27% followed all of it! So, only 6% of employees have obtained financial guidance and implemented all the advice. Why? Unfortunately, 33% of those receiving the advice didn't trust the advice. Among retirees, more than 40% of those seeking advice said that they ultimately couldn't afford to pay for it. Another 20% said that they had other ideas, plans or goals.

"One reason why retirement confidence has remained low despite recent improvement in the markets and ecomomy may have to do with the fact that participants are just beginning to realize how much they will need to save annually to fund a "decent" retirement."

Given that info, it is not surprising to see why we have such an issue with retirement planning and funding. With only about 50% of the surveyed respondents in a plan, and only 23% of those seeking advice, and then only 27% following it, we have only about 3% of our workforce receiving full retirement counseling.

How Much Is Enough?

One reason why retirement confidence has remained low despite recent improvement in the markets and economy may have to do with the fact that participants are just beginning to realize how much they need to save annually to fund a "decent" retirement. The later one starts to fund their retirement the more they need to put in annually.

Saving rates should be based on your household income, what probability of success you want in reaching your goal, and the age at which you start saving according to Dimensional Fund Advisors (DFA), a mutual fund firm based in Austin, Texas. The first step to determine an appropriate saving rate is to estimate how much retirement spending will be financed with retirement savings and this estimate is specific to each individual.

Specific saving rates depend on many things, such as income paths, portfolio returns, and assumed withdrawal rates, in addition to your desired probability of success. Another important consideration is the income track that one follows. For higher income earners, one should increase the annual savings rate as income grows or they will likely fall short of their long-term objective.

The Expense Side of the Equation

For most of us planning a retirement budget, we have to categorize our expenses based on priority and likelihood of occurrence. Expense items should be broken down from highest to lowest priority. Non-discretionary items, such as housing, food, clothing, and healthcare, should be given the highest priority, with discretionary items, such as home improvements, dining out, vacations, and entertainment being given a lower priority. Unfortunately, one needs to factor in the onerous impact from inflation and unexpected emergencies.

At the same time, one needs to project the sources of income that will be used to support the non-discretionary and possible discretionary items, including Social Security, a defined benefit pension plan, the retirement portfolio, proceeds from a sale of real estate, and/or part-time employment, which seems to be a growing trend among “retirees”.

A general rule of thumb suggests that non-discretionary items will represent roughly 70% of your spending. However, each person’s situation is unique. What might be classified as discretionary for one, say a vacation, may be a non-discretionary item for someone else. Charitable giving may also fall into this category, especially if you regularly give to your religious institution.

> *“To achieve this goal, sponsors need to provide plan features that can help plan participants, such as auto enrollment, loan limitations, employer match provisions, use of index funds and target date funds, and most importantly, the availability of investment education.”*

For many of us, a happy retirement is in the offing, but it won’t be easy and it won’t come without a cost. Achievement of a reasonable retirement takes planning and discipline. While we are working we must live below our means while also contributing to our plan. Furthermore, we must work to retire our debts prior to when we retire. Lastly, we can argue whether the Social Security system will continue to function as it has in the past, but we need to prepare for a retirement that doesn’t rely solely (or heavily) on monthly payments from Social Security. This may be a little easier for higher wage earners, but for those making less than $35,000 per year, it is estimated that more than 90% of one’s retirement income will come from Social Security.

Do the Right Thing

401(k) plan sponsors are challenged with assisting employees with their retirement readiness. To achieve this goal, sponsors need to provide plan features that can guide employees down the right path. There are specific plan features that can help plan participants, such as auto-enrollment, loan limitations (*Fireside Chat* August 2012), employer match provisions, use of index funds (*KCS White Paper*) and target-date funds (*Fireside Chat* December 2012) and most importantly, the availability of investment education. We embrace these concepts, and would be pleased to discuss them with you.

To read any of the above-mentioned publications, please see our website at *www.kampconsultingsoultions.com* and click on the “Publications” tab.

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