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Reilly Financial Advisors

Wealth Strategies

Your Retirement Paycheck;
Do You Truly Understand Your 401(k)?

Part 5 of 12

The days of the corporate-funded pension plan are long gone. Essentially we are now left to our own devices when it comes to saving for retirement. We must create our own paycheck, per se, for retirement, most often through employer-sponsored retirement plans.

You've now been given the reigns to take control of your future financial life, so what exactly do you need to know? What is important in understanding and navigating through these types of plans? A few key questions include:

1. **Does your company match your 401(k) contributions, and if so, how much do they match? But more importantly, what does “match” mean?**
2. **What are your investment options within the plan?**
3. **Are there costs or fees associated with the plan, and if so, what is the overall cost to you?**
4. **How much should you contribute to your 401(k) and how should you allocate those funds in order to support yourself in retirement?**
5. **Is there anybody to help guide you through these nuances?**

While it is very important to answer the questions above, it is equally as important to understand the history behind these employer-sponsored retirement plans in order to best utilize them.

For decades, it was almost silently understood that employees would be cared for, financially, in retirement by their employers through employer-sponsored defined contribution

(pension) plans. However, over time as companies were sold, declared bankruptcy, or no longer had adequate funds, it was becoming more and more evident that these plans would no longer be able to subsidize workers in retirement. In 1974, the Employee Retirement Income Security Act



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(ERISA) was passed, and began regulating pension plans, mostly to ensure the payment of guaranteed pension premiums. In 1978, The Revenue Act of 1978 established a new type of retirement plan (qualified deferred compensation plans, widely known as 401(k) plans), one in which employees themselves were widely responsible for funding in order to save for retirement.

From 1978 until the early 2000's, it can be said that the “401(k) industry” was more of a Wild Wild West; one free of many regulations, legislation, and rules. The Pension Protection Act of 2006 (PPA) was passed as a means of bringing more regulation to the fraught industry by establishing funding rules for defined benefit plans, providing auto enrollment into the plans, removing conflict of interest fiduciary liability, providing more control over investment options, and establishing many additional benefits to employees who partake in the plans.

While the PPA has brought much needed regulation to the industry, it is still very important to understand what is available within your plan in order to best save for *your* future.



Game, Set, Match

Think of a match as a “bonus”, or free money, from your company! Many employers offer a company match as part of their overall benefits package. Match contributions can vary, and may be made through a percentage of your salary or a set dollar limit. It is common to find a matching contribution of 50% of employee contributions for the first 6% of salary that the employee contributes, essentially a 3% overall matching contribution. It’s important to note that this free money effectively increases your income, without increasing your taxable income!

In order to find out if your company offers a match, you will need to ask your Human Resources representative or somebody within the organization that helps to administer and monitor the 401(k) plan.

Choices, Choices, Choices

Investment options within an employer-sponsored retirement plan vary widely by provider. While the most common type of investment choice within a 401(k) are mutual funds, it is also possible to invest in company stock, individual stocks and bonds, and Exchange-traded funds, to name a few.

A mutual fund is a pool of funds collected from many investors for the purpose of investing in stocks, bonds, and larger assets. Mutual funds are operated by money managers, who invest the capital with the goal of producing income for the end investor. Mutual funds must adhere to their predetermined investment objectives as stated in the fund prospectus. Mutual funds provide the opportunity for the smaller investor to participate in the stock market by purchasing smaller shares of stocks and bonds, which would generally be unavailable or limited based on the small amount of capital.

Larger companies that are publicly traded in the stock market may offer the opportunity for employees to purchase shares of their company stock. While this can be a great opportunity for employees, it is always important to ensure that one doesn’t over-expose themselves to risk by not properly diversifying retirement plan assets.

Some employer-sponsored retirement plans may offer a Self-Directed Brokerage Account (SDBA) in which employees can utilize retirement plan assets to directly purchase stocks and bonds. Stocks represent a stake of ownership in a corporation, and provide a claim on part of the corporation’s assets and/or earnings. A bond, conversely, is a debt investment in which an investor is essentially loaning money to a company (corporation or government) for a

defined period of time at a fixed interest rate. Bonds are typically used to raise capital to finance various projects.

Exchange-traded funds, or ETFs, are similar to a stock in that they trade on the stock exchange. However, ETFs track an index, commodity, or an index fund and experience price changes throughout the day. While it is widely compared to a mutual fund, it differs by being traded openly on the market during the day, rather than at the close of the day.

Which types of investments are available to you will directly guide how you invest within the plan.



Nothing is Free

As the old adage goes, nothing in life is free. Regardless of which type of investment you choose within your retirement plan, there are costs and fees associated with those investments. In addition to the fees associated with the investments themselves, 401(k) plans carry costs and fees that must be either paid for by the plan sponsor (employer) or absorbed by the plan participants (employees).

Mutual funds and ETFs themselves have what are known in the industry as “expense ratios”, a percentage of overall purchase price that is used to pay the fees associated with the fund. Stocks and bonds usually have transaction fees which are charged each time a position is purchased or sold.

In addition, there are costs associated with the administration and maintenance of the plan. Day-to-day administrative service fees can include the cost to maintain proper records of the plan (recordkeeping fees), administration costs (third-party administrator fees), the cost to hold the assets (custodial/trustee fees), and advisory or consulting fees. Oftentimes, these fees are passed onto plan participants (employees), therefore it is important to understand what and how much you are paying.

Contributions, Allocations, It's All Greek to Me!

You must now evaluate your own retirement plan and the options available to you in order to create a strategy that best fits your individual financial situation. First, you must determine the amount that you will contribute to your plan. A good rule of thumb is to contribute as much as necessary in order to maximize your employers' match. To revisit our previous example, if your employer will match 50% of up to 6% (or 3%), you should contribute 6% at a minimum. There are many free retirement plan calculators available online to help you calculate what makes most sense to you and your individual financial sense.

Contributing to the plan is only half of the battle. Once you've decided how much you'll contribute, you must now decide where to put that money, or your overall allocation. As previously discussed, you likely have access to a multitude of invest-

ment options. These options are likely to range from aggressive to defensive in nature, and offer different amounts of risk and return. Asset allocation, simply put, is the balance of risk and reward within your investment portfolio, and evaluates an individual's goals, investment horizon (time until retirement), and risk tolerance.

Because each person's financial situation varies, there is no black and white answer to what is proper asset allocation. Therefore, it is important to evaluate your own goals, financial security, and future retirement needs in order to decide how to properly allocate your funds.

Now What?

By now, you may be thinking “wow, there are a lot of things I need to know about my 401(k)”. You may also be asking “Is there anybody out there to help me?”

There are many resources available to help you in understanding your plan specifics, and how to maximize the plan based on your situation. Begin by speaking with your Human Resources department to learn if there is a professional advisor or consultant available to assist. According to the Retirement Advisor Council, about 75% of plan sponsors use the services of an Investment Advisor for their retirement plan. However, it is important to note that not all of these advisors are allowed to provide direct advice to the plan or the participants regarding investments. It is also always important to understand the fee structure and compensation of the advisor to ensure that they are not providing suggestions based on how they are paid, which would result a conflict of interest.

About RFA

Reilly Financial Advisors is a fee-only Registered Investment Advisor, aimed at helping our clients both define and achieve their individual financial goals through four unique service offerings:

1. **Wealth Building – for those still accumulating their investment portfolios**
2. **Wealth Management – for those who have amassed their savings and have specific needs associated with their wealth**
3. **Wealth Legacy – for those who have accumulated a significant amount of wealth and face unique wealth transition needs**
4. **Corporate Retirement Services – tailored solutions for plan sponsors and participants**

RFA, founded in 1999, services clients around the United States and in more than a dozen countries worldwide. As an independent advisor, we are able to provide our clients with the highest level of Fiduciary services which allows us to make investment decisions based solely in the best interest of our clients. Our goal is to be our client's first point of contact for all of their financial needs, serving as a trusted financial partner for the long term.

Do you know the answer to the following questions?

We encourage you to take this handout into your Human Resources department in order to find the answers!

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