

Smart Automatic Retirement Plan Investing

Retirement Saving Made Easy

As a participant in an automatic 401(k), 403(b), the federal Thrift Savings Plan or other retirement savings plan, you are part of a growing trend in saving for retirement. An automatic plan offers one or more features that require no action from you, the employee. The most common automatic feature is enrollment. Employees are automatically enrolled at a pre-set contribution rate, and also automatically placed into a pre-selected investment fund. You may also be taking part in automatic increases in your savings rate or other automatic features that help build retirement savings over time.

Automatic features make saving simple and help you save more—and often earlier—than you would otherwise for retirement. They also provide tax advantages since your earnings accumulate tax-deferred, allowing your account value to compound undisturbed until you're ready to retire. Even better, you can continue to participate as long as you work for your current employer or any employer that offers a 401(k) or comparable plan, though not all employers may offer automatic features.

With these strengths, it's perhaps not surprising that a growing number of companies are adding automatic features to their retirement savings plan. More than 40 percent of companies with 401(k)s now offer automatic enrollment,¹ and other automatic features are catching on.

But auto-enrollment isn't the same as autopilot. There are decisions you can and should make as a plan participant, just as your employer has made decisions about your initial contributions and how they are invested. The more you know about how these plans work, the principles that underlie smart retirement savings plan decision-making and the ways that your account is—and can be—invested, the more confident you can be about the choices you do make.

This brochure will help you understand your automatic plan and point out what aspects you should pay close attention to. But before we delve into the details of an automatic retirement plan, let's cover some basics. While this brochure primarily focuses on 401(k) plans, the majority of information can be applied generally across retirement savings plans.

Retirement Savings Plan Basics

401(k) and 403(b) plans are two of the most prevalent employer-sponsored retirement savings plans. When you participate in a 401(k) or 403(b) plan, the income you will receive from the plan after you retire will be determined by:

- the money contributed to the account during the years you participate in the plan;
- the way the money that's put into the plan is invested; and
- the average annual return the investments provide.

Both 401(k)s and 403(b)s are what are known as salary deferral plans, which means a percentage of your earnings are contributed to an account in your name rather than being included in your take-home pay. When you participate in a traditional salary deferral plan, the taxable salary your employer reports to the IRS is reduced by the amount put into your account—and you do not have to pay any income tax on that money until you withdraw from your account, usually after you retire. Any earnings on your contributions are also tax-deferred while they remain in your account. This means your combined contributions and earnings can potentially compound at a faster rate, since all of your earnings get reinvested and no money is being taken out to pay taxes.

The tax you eventually pay depends on your income tax rate at the time you withdraw. For example, if your taxable income, including the withdrawal, puts you in the 28 percent federal tax bracket, your tax will be figured at that rate. Although there is no way of predicting what your income tax rate will be when you withdraw from your account, many people have less income in retirement than they did when they were working, and so pay tax at a lower rate.

Roth Contributions to Your Salary Deferral Plan

Some 401(k) and 403(b) plans allow Roth contributions in addition to traditional or pre-tax contributions. Roth contributions to your 401(k) or 403(b) plan are not tax-deferred, so contributions don't reduce your current income taxes. However, withdrawals are tax-free if you're at least 59½ and your account has been open at least five years when you take the money out.

403(b)s—Looking A Lot More Like 401(k)s

Recent changes to the 403(b) regulatory landscape are making 403(b) plans much more like their 401(k) counterparts. If you work at a public hospital, are part of a public school district or a number of other eligible organizations or affiliations, your employer may offer a 403(b) plan. This plan allows investments that range from annuity contracts provided through an insurance company to mutual funds virtually identical to those offered through a 401(k) plan.

As with a 401(k) plan, a 403(b) plan allows you to defer income tax on allowable contributions until you begin making withdrawals from the plan, usually after you retire. Allowable contributions are excluded or deducted from your income. There is also a Roth 403(b) option. If your organization offers one, any contributions made to a Roth option requires that you pay income tax on the contributions to the plan but distributions from the plan (if certain requirements are met) are tax-free. Like a 401(k), any earnings and gains on amounts in your 403(b) account are not taxed until you withdraw them, while earnings and gains on amounts in a Roth program are not taxed if your withdrawals are qualified distributions.

Automatic Plans

Traditional retirement savings plans require the employee to make the vast majority of the decisions—for example, whether to participate in the plan, how much to save and what to invest in. An automatic retirement savings plan is simply a plan that offers one or more features that require no action from you. As mentioned above, one of the most common features is automatic enrollment. Employees are automatically enrolled at a pre-

set contribution rate, and also automatically enrolled into a pre-selected investment fund. Many plans also automatically increase your savings rate, which helps build retirement savings over time.

With an automatic retirement plan, your employer sets up an account in your name in the company's plan as soon as you're eligible. Once you're enrolled, a percentage of your pretax salary is automatically contributed to that account every pay period and put to work in the investment your employer has chosen for the plan, often referred to as the plan's "default investment."

Your employer also establishes the percentage of salary that you contribute to the plan. While a majority of employers use 3 percent as the default amount, an increasing number automatically enroll their employees at 5 or even 6 percent and higher—helping the employee build a more substantial retirement nest egg. Some employers increase the initial percentage over time, often by one percentage point each year, as you continue to participate in the plan. This process is known as automatic escalation.

You can change the contribution amount or decide not to participate at any time. If you decide you don't want to save through the plan, you can decline automatic enrollment. You have 90 days after contributions start to inform your employer, and they will return your contributions (adjusted for any investment gains or losses) in a future paycheck. You will lose any employer matching contribution made up to that point and the amount returned is taxable income.

And remember, before your employer takes any action regarding your 401(k), 403(b), Thrift Savings Plan or other retirement plan they are required by law to send you detailed information about the plan and give you the opportunity to opt out of the plan. You should look for this information during the first several months of your employment.

Key Features of Automatic Enrollment Plans

When you're automatically enrolled in your plan, you always have the right to change the defaults your employer has chosen—the key defaults you should be aware of are the contribution or savings rate, the auto escalation rate (if any) and the investment your contributions are automatically directed into.

The Savings Rate

When you're enrolled, your employer withholds a certain percentage, called the default savings rate or default contribution rate, of your gross pay and deposits it into an account that's been set up in your name. You can change your contribution rate as frequently as your employer allows, which is usually on a daily basis but may be less often. For example, if you receive a raise, you may decide that you can afford to put away more toward retirement and boost what you're contributing from the default rate to 8 percent, 10 percent or even more.

To make saving for retirement less financially jarring, particularly for newly hired employees, many automatic plans start with a fairly low default savings rate of 3 percent. However, 3 percent may not be a high enough savings rate to ensure a comfortable retirement, so increasingly plans are setting default savings rates of 4, 5 or 6 percent.

In addition, you may have a company match. Matching contributions are amounts your employer adds to your account over and above the amount that's deducted from your pay. Matching isn't required, but many employers offer this feature to help employees increase their retirement savings, attract and retain employees, encourage plan participation, benefit from the tax deduction it provides or help ensure that their plan is exempt from discrimination testing. Your employer determines how the match is calculated and whether to contribute cash or shares of company stock. A typical approach is to match \$.50 per dollar up to 6 percent of pay, but many other matching formulas exist.

Ideally, default savings rates are set to at least ensure you receive the full match from the company, but if the default savings rate does not result in you receiving the full match, then you may want to increase your savings rate.

Make the Most of Your 401(k), federal Thrift Savings Plan or 403(b) Match

In some plans, the automatic savings default is set at an amount that is less than the employer's match. If this is the case, unless you decide to take action and increase your contribution level at least to the level of your employer's match, you may be passing up free money. For more information, see FINRA's Investor Alert, [Why Leave Money on the Table? Make the Most of Your Employer's 401\(k\) Match](#).

Automatic Escalation Helps Keep Savings on Track

Since default savings rates are often set a little on the low side, some automatic plans have addressed this issue with what is called an automatic escalation feature. With auto escalation, your savings rate is automatically increased by one or more percentage points a year until it reaches the maximum default rate for the plan—often 6 percent, but some companies continue to escalate up to 10 percent or more.

Auto escalation allows a participant to begin contributing at an often modest initial savings rate, but systematically increases that rate each year. It is a great way to increase your savings rate over time, and since the savings increases are done automatically and are usually timed to correspond with a pay raise, your pocketbook may not even notice the increase in savings.

How Much Should You Save?

A good rule of thumb is that your total contributions to your plan—that is, your contributions plus any employer matches—should be about 10 to 12 percent of your salary. Another estimate is to save in such a way as to ensure you will retire with 10 times your last year's salary (\$500,000 if your final salary is \$50,000). In 2012, you can contribute a maximum of \$17,000 to a 401(k) or 403(b) plan—plus an additional “catch up” contribution of \$5,500 if you are 50 years old or older.

Default Investments

When you're automatically enrolled, your employer chooses a default investment for your contributions. You can stick with that investment if you wish, or you can move your money into different investments offered by the plan. The default investment will likely be a lifecycle fund, a balanced fund or a managed account—these are the types of

investments that the federal government has approved as acceptable defaults in automatic 401(k) plans.

Lifecycle Fund

There are two different types of lifecycle funds, but the type of lifecycle fund found in automatic plans is often a target-date fund (the other lifecycle type is a target-risk fund). Target-date funds are professionally managed investments primarily designed for retirement investors who are looking for a “one-stop” investment solution. Funds such as the Federal Thrift Savings Plan’s L Funds offer investors an easy way to create a well diversified portfolio, without having to make specific investment and allocation decisions.

A target-date fund gets progressively more conservative as the fund approaches its “target” date. In other words, the asset allocation of the fund shifts from riskier equity investments to more conservative bond investments, or even cash or cash equivalents. The asset mix is chosen based on the date when you will need to use your money. If that date is a long time from now, the target-date fund will be more heavily weighted toward stocks or stock mutual funds, which historically have provided a higher return than bonds and cash investments, but also expose investors to higher levels of investment risk. As the date when you will need your money approaches, the investment mix automatically becomes weighted more heavily toward conservative fixed-income or stable value investments, including bonds and Treasury securities. This gradual shift to more conservative investments is called the “glide path,” and it is designed to reduce your risk as you approach retirement.

To invest in a target-date fund, investors choose the fund with the name closest to the date they plan to retire. An investor who is age 30 in 2010 would likely retire in the year 2045 when she is 65 years old, so she would choose the 2045 target-date fund. Similarly, a 50-year-old investor might choose the 2025 fund. But in the case of automatic enrollment, you will automatically be placed in the target-date fund that is right for you.

Related but Not Identical

Lifecycle funds with the same target date aren’t all alike. The funds that make up a fund of funds can vary substantially from provider to provider. Some lifecycle funds adopt fairly aggressive allocations, with assets invested more heavily in stocks as the target date approaches. Others have a more conservative mix. You can find the combination of investments that make up a lifecycle fund’s portfolio in its prospectus, which your employer should make available to you.

Balanced Funds

Balanced funds are popular default investments. This type of mutual fund is broadly allocated because each fund’s manager, or computer model if the fund is passively managed, invests in a combination of stocks and bonds to provide both potential growth and current income.

Balanced funds have several strong points. By holding multiple asset classes, balanced funds tend to be less volatile than either pure stock or pure bond funds. Yet historically this reduced risk hasn’t resulted in a significantly reduced return. That’s because in periods when stocks are underperforming, returns on the bonds may offset those losses.

Balanced funds do differ from lifecycle funds in one important way. The allocation isn't modified to accommodate a specific retirement date, though it may change to reflect changing market conditions. So, shifting out of a default lifecycle fund generally means you assume responsibility for allocating and diversifying your own portfolio.

Managed Accounts

If your default investment is a managed account, your savings will be invested in a portfolio of various mutual funds or possibly individual securities that are chosen by a professional investment manager. The way the account is structured will depend on the plan provider your employer chooses to provide this default investment.

Managed accounts are similar to managed mutual funds, as both have financial professionals who follow a specific investment style—ranging from conservative to aggressive—and who select securities to meet a particular objective, such as long-term growth or income for retirement. Unlike a mutual fund manager, the account's investment manager oversees many similar but not necessarily identical accounts simultaneously, and will typically make the same transaction for most or all of the accounts.

Unlike individual mutual funds or lifecycle funds, with a managed account you may have some control over the exact mix of investments in your portfolio and when that mix is reallocated, because the managed account manager will usually permit you to provide some input about the risk you are willing to take on. However, this customization does come with a price. You will generally pay a fee for a managed account service that you would not pay if you used a lifecycle fund or a balanced fund.

Other Investment Options

Although you will most likely be defaulted into a lifecycle fund, balanced fund or managed account, most employers offer at least three alternatives to their default investment. These typically include a stock fund, bond fund and money market fund, and some offer even larger menus. The average plan offers between eight and 12 choices, and some plans offer as many as 100. So you always have the option of moving your assets out of the default investment or choosing other investments to supplement your default investment. More information about the funds in your plan is available from the plan provider—the financial services company your employer has chosen to provide its 401(k) or other retirement savings plan.

Investing Comes With Risk

Investing nearly always means taking the risk that you could lose some, or even all, of your principal. In a retirement savings plan, principal is the amount that's contributed from your salary, and the amount on which earnings accumulate. But not every investment carries the same level—or even the same type—of risk, so make sure you understand the nature of your investment. A good way to do this is to read each prospectus of the funds in which you invest, which contains risk-related information, as well as the quarterly reports you receive.

Changing Your Defaults and Opting Out of Your Automatic Plan

The defaults for your plan were chosen because your plan sponsor believes they will both minimize the risk of large losses and provide long-term growth.

However, as mentioned, you can change any of the default settings you like—that is, the contribution rate, the default investment and the auto-escalation rate. Plans allow at least quarterly changes, but most plans allow you to change your savings rate, investments and auto-escalation feature on a daily basis. While the default investment is a good investment for many participants, you should consider your personal circumstances to determine which fund(s) best serve your needs. If you do change your defaults, make sure you fully understand the repercussions of the change and how it could affect your retirement savings prospects—and be sure to review the investment options and obtain information on them through each fund’s prospectus.

In addition, in some cases, it may simply not be financially possible for you to make contributions, in which case you are able to opt out of the plan. While not contributing will have a long-term impact on retirement saving, it is an option you can take. Your employer will let you know how long you have—often 90 days—to decide on the steps you need to take. If you act within that timeframe, the money that was paid into to your account will be returned to you, and you won’t owe a tax penalty for early withdrawal. If you miss the deadline, you’ll still get the money back, but you will owe a 10 percent penalty on the amount that’s returned. Whether or not a penalty is due, you’ll owe income taxes on the amount that’s returned to you.

Fees

Investing in a 401(k) or other retirement savings plan is not free. There are a number of fees that you and/or your employer must pay in order to receive the services required to operate the plan. Here’s a look at some of the types of fees you might pay in addition to sales charges that may apply to certain choices within your plan.

Administration Fees. Your plan administrator takes care of or arranges for the recordkeeping, accounting and legal services required by your 401(k) or 403(b), but these services come with a price tag. The fees that you pay vary, depending on your plan’s provider, the size of the plan and the services it offers participants. In addition, some employers cover some or all of the administrative fees.

Investment Fees. Investment management fees, which you pay on every investment in your portfolio, generally account for the largest portion of the fee total. These asset-based fees may range from as low as 0.02 percent to 2.5 percent or higher. One complicating factor is that you may pay at different rates within a single plan based on the investment choices you make. For example, fees on bond funds tend to be lower than on actively managed stock funds, and fees on index funds, if offered by your plan, are usually lower still. On the other hand, that doesn’t mean you’ll want to avoid a fund simply because it has higher fees. It may add important diversification to your portfolio, which may be the case, for example, with international funds. Keep in mind that some investment charges may apply only in specific circumstances. If you know what those situations are, such as fees for moving money out of a stable value fund, you are able to make more informed choices about how to invest and when to make a change.

Service Fees. Some fees are only charged on specific services—loans being the most common. However, fees are also charged on other services such as managed account services and hardship withdrawals. Furthermore, some service fees can be more expensive depending upon the manner in which you communicate with your plan service provider. In some instances, it is significantly cheaper to transact over the Web than it is to handle a transaction with a phone associate. Since loans are the most common type of fee, a quick look at loan fees is warranted. You may or may not know that you are often permitted to take a loan from your 401(k), but it will cost you (for more information on loans in 401(k) plans, check out FINRA’s [Smart 401\(k\) Investing](#) section on loans). Loan fees can vary from a small percentage of the amount you borrow to a rather substantial percentage of the total value of what you’d be eligible to borrow. It pays to check what costs would apply before you commit yourself. For additional information on all types of fees, see the Department of Labor’s [A Look at 401\(k\) Plan Fees](#).

Five Tips for Smart Automatic Investing

These tips will help you make the most of your company’s automatic features:

- 1. Know Your Defaults.** Familiarize yourself with the default savings rate and investment selection your company has chosen for you. Ask yourself if you are saving enough—and take the time to read the prospectus associated with your investment.
- 2. Take Full Advantage of a Employer Match.** Most automatic plans set a default rate that ensures you receive the full match—but if not, increase your saving rate to make sure you’re putting enough away to grow a robust nest egg over time.
- 3. Go Up the Savings Escalator.** If your plan offers automatic escalation, stick with it—annual increases are a great and often painless way to increase your savings. If not, be disciplined and do it yourself. Remember that if you’re not saving at least 10 percent of your salary, chances are you’re apt to come up short when retirement rolls around.
- 4. Open and Read Your Account Statements.** Your employer must give you an account statement at least once every quarter—and plan providers often send you statements on a monthly basis. You may also be able to access account information online. Make a habit of looking at your statements each time you get them, and ask questions about anything you don’t understand.
- 5. Don’t Opt Out—or Cash Out.** Significant tax advantages and often an employer match come with your plan—important benefits you lose if you don’t stay in the plan. Even worse, if you opt out—you may not get back in for a while, which can put you way behind on your savings. If you leave your organization, resist the urge to cash out even a part of your savings for something you think you need. Retirement savings is just that—for your retirement.

Where to Go For More Information

Your Account Statement. You can keep track of how your investments are performing by checking your account statements. Your employer is required to provide them at least four times a year, typically at the end of March, June, September and December. Many

plan providers, however, send you statements on a monthly basis. You may also be able to access your account information online.

Your Employer and Plan Administrator. Your employer or plan administrator may offer resources to help you with your investment decision making and retirement planning. Many employers provide educational material and seminars about retirement planning and saving. In addition, they may offer financial advice on your plan through a third party advisory service like a managed account.

Online Resources. There are many websites sites that specialize in 401(k) information and advice, including the plan provider your employer has chosen. Your plan provider's website is often the best resource to find historical performance information related to your investments and descriptions of your investment options. Many providers offer resources to help with asset allocation and other decisions, not to mention practical information on saving and investing.

Investment Professionals. You also may want to consult an investment professional. You can obtain investment advice through most financial institutions that sell investments, including brokerage firms, banks, mutual funds and insurance companies. You can also hire an independent investment adviser, accountant, financial planner or other professional to help you make investment decisions.

- For more information, see FINRA's [Selecting Investment Professionals](#). Ask any potential advisers about their backgrounds, what credentials they have and how they earned those credentials. Also ask for an explanation of their fees. Most importantly, check their backgrounds. [FINRA BrokerCheck](#) tracks the credentials of licensed brokers.
- For more information about what credentials, such as CFP, stand for, go to FINRA's [Professional Designations Directory](#).
- The [SEC's Investment Adviser Public Disclosure](#) website allows you to search for information about investment adviser firms registered with the SEC. You may also contact your [state securities regulator](#).

¹ Plan Sponsor Council of America (PSCA), *54th Annual Survey of Profit Sharing and 401(k) Plans, 2011*.