# 401K PLAN OPTIONS

# DISCLAIMER

This book is not meant to substitute for the advice of a financial planner or other investment professionals. It is meant to give you some background information on how your retirement investment funds are supposed to work and how they've held up since. Most 401(k) plans suffered heavy losses since late 2008 but, certainly not all of them, and that's the difference.

However, just because most 401(k) plans are facing drastic losses doesn't mean they're not still the preferred method of storing money for a retirement that looks increasingly uncertain for anyone under 50 years old. There are plenty of less dramatic solutions to the falling banking and investment markets than pulling your funds out of a relatively stable type of "financial vehicle[1]."

Remember, each situation is unique. While this book attempts to take into account the variables that affect the average 401(k) account, your personal situation may differ significantly. It is always prudent to consult a professional when possible if you decide to take any sort of action with your 401(k) or similar retirement savings account.

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1 Any financial venture could be considered a monetary vehicle if things of value are being traded and converted from one type of value to another, through trade. Increasingly, this has come to include more esoteric types of "value creation," such as loan repackaging and unsecured fund management.

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# INTRODUCTION

Since they were introduced in the 1970s, the reach of 401(k) plans as retirement savings accounts has risen sharply. Up from just over 60% participation before major rule changes in 2006, it is estimated that nearly 90% of earners take advantage of these accounts to save for retirement, as of the late 00's. Nearly 50 million workers and their employers have contributed what stood at 3 trillion dollars at the beginning of 2008. A year later, that last figure is considerably lower.

A 401(k) account allows your employer to make a contribution to your retirement without having to be responsible for a pension, making it attractive to both sides. Often, an employer will match your contributions up to a specific percent of your earnings or maximum annual contribution, as determined by your income. While they are more attractive to high-income earners, they also have advantages for most workers.

As a contributor to one or more 401(k) accounts through your working career, you'll be investing a portion of your income into some type of financial vehicle – most often a combination of them. This has brought a much larger percentage of Americans into the stock market than have been for many decades.

Company plans are sometimes cooperative and allow you to take advantage of a "group rate" that can save costs on fees and give access to exclusive funds. Even then, most of these services are not freely available to worker/investors. It is convincingly argued that for 401(k) accounts to remain affordable for wage earners in an era of falling wages is twofold:

- either the fees must be reduced (somehow)
- or the regulations that penalize lower-income earners must be adjusted

Neither is very likely, and the depth of the crisis will probably determine how many middle-class investors will the stock and mutual fund markets[2]. For those lucky enough to remain employed, companies will also continue to offer 401(k) plans (with and without matching funds). At the very least, most workers who make more than the minimum wage expect their employers to at least responsible for paying to have the account set up on their behalf, even if they don't contribute.

The contribution limit changes each year according to inflation and increasing by $500 increments. Individual limits for for 2009 is set at $16,500. Additionally, older earners are able to contribute more to "catch up" -- as much as $5,000 more each year for earners over 50. This can add up to significant savings that can supply the majority of income over what might be as many as 30 or 40 years of retirement[3]. Given that most people (statistically represented as the lower 80% of earners by researchers) keep the majority of their equity wrapped up in their house and more liquid assets like savings accounts, losses in these assets affect these (majority) populations disproportionately.

The typical 401(k) account, at the end of 2008, had suffered an average decrease in value of 20-40% (as compared to the previous year), depending upon how aggressively the fund is invested in the stock market. As a result of this precipitous drop in value, a great many people are now getting concerned about the safety and fluidity of the money they have remaining in their retirement accounts, including 401(k) plans.

In the nearly 40 years since its inception, the definition of a 401(k) plan has changed. What was once a new idea about how to store money into an

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2 stocks being the more volatile of the two, responding quicker and with more voracity according to market changes

3 for people in good health

uncertain future became a venerable financial vehicle, like life insurance. The difference between that and an 401(k) is how long you have to wait to draw on the money that is saved – most people now opt for the income that one can draw while they're still alive to enjoy it.

With a stock market that has performed reasonably well over several decades[4], people have grown accustomed to assuming a relatively high rate of return and a higher retirement income than may have been reasonable, under the circumstances. There will probably be quite a bit of second-guessing when it comes to divvying out the blame for the financial crisis of 2007-whenever.

The fees and mismanagement that people have become aware of in the latter half of the 00's have always been part of retirement savings banking options, including those that were most heavily advertised and supported by ever-more loose definitions of those allowed financial plans. Unfortunately for many, that includes the 401(k) they've been contributing to for years.

This book would hope to help allay some fears and give some useful background information for those trying to decide the best way to save what investment money they have remaining from being gobbled up by inflation, market losses and mismanagement.

4 The recessionary period of the early 1980s is the most notable exception to the overall good performance of 401(k) accounts since their inception.

# 1

# DEFINING THE 401(K) PLAN

In the most basic terms, a 401(k) plan is a financial investment that allows a saver to defer the payment of taxes in various types of investments until the money is withdrawn, typically when the worker retires at the age of 65 or 67. The account is set up by an employer and very often contributed to by the same. The funds are off-limits until retirement, but most people may begin drawing on their 401(k) funds without penalty when they're 59.5 years old or older, according to IRS regulations for 2009[5].

The IRS lists the 401(k) as one of several types of "deferred contribution plans" where a set proportion of pre-tax earnings are contributed to the plan along with untaxed, matching funds from the company. You still have to pay Medicare, FICA, Unemployment and Social Security taxes on your gross income, but you don't have to report matching contributions as income.

401(k) plans come in two basic types, depending upon how much control the investor has over how the funds are invested.

## PARTICIPANT-DIRECTED 401(K) PLANS

This type of account has become far more common in recent years. Such funds allow each investor some measure of control regarding what type of stocks or funds the investment is part of. They are most often offered to

5 This will surely change over time due to program stress from the top of age delineated bar charts used by sociologists.

professionals but, have increasingly made inroads among lower-wage workers. The annual fees on these “self-directed” plans are somewhat higher. Trades made make on individual stocks are subject to transaction fees.

To do a good job of this that you’ll have to educate yourself if this is something that you intend to actively manage, but not over-do. Not everyone is up to the job. You have to very frankly assess your own ability to manage sometimes complex financial gibberish unless you hire a professional that speaks the native language.

Most financial professionals have recommended focusing on long-term investments. Even during the Great Depression of the 1930s, investments that remained in companies that didn’t go under during the worst of it were rewarded after the crisis was long over. Stock investments, for instance, should demonstrate long-term stability.

If you are responsible for directing your own 401(k) plan, you may also be responsible for sending in some of the necessary paperwork. This is often the most daunting task and one that is not commonly farmed out to investors as an option. More often you’ll be granted some additional options for management that those in trustee-directed plans.

## TRUSTEE-DIRECTED 401(K) PLANS

Some accounts are maintained and directed by a trustee, who is defined by the IRS as a party authorized to take ownership of assets for someone else’s benefit. It’s not just for the very aged – that’s the same way a third party manages your 401(k) for you. Not only do these companies file all the necessary paperwork and reporting for you, but they are also responsible for the wise manipulation of those funds in the banking sector or public marketplace.

A full trustee takes control of all aspects of managing your 401(k). This has been done by banks in the past, but is increasingly directed by private companies that specialize in providing financial services. In fact, many of these accounts are managed by 401(k) vendors that maintain regular reports on individual plans with online systems.

Other types of program give you more control, but are also partly responsible for some of the problems being encountered by many savings plans since the economy has hit a bump. In fact, the plans that have been managed by professionals have performed, as of the end of 2008, largely according to how willing the managers were to invest in real-estate related loans and loan packages – provided they even knew that's what they were investing in.

Sometimes your company manages the 401(k) program for you, in house. Often such plans include company stock options that tend to give employees little (if any) control over the investment or management of the stock portion of your matching funds. Even if you are no longer employed by the company in question, you may be required to keep your money in a loosing stock should they continue to manage it, and the monies aren't turned over into an IRA or a similar type of investment vehicle.

## HOW 401(K) PLANS DIFFER FROM IRAS

An Individual Retirement Account (IRA) is another type of investment plan that allows you to take advantage of special tax-related provisions set out by the US Government when saving for retirement. The biggest difference between a 401(k) plan and an IRA is the amount of money that can be invested in the plan each year.

Also, IRA accounts are not typically contributed to by an employer. However, in recent years, both the SIMPLE[6] and SEP[7] types of IRAs are now available

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6 Savings Incentive Match PLan for Employees, according to the IRS

to workers as a plan set up by their employers.

## CONTRIBUTION CAPS

Contribution limits are defined as set dollar amounts rather than a percentage of total earnings. The 2009 contribution cap for both salaried and wage earning workers is $16,500. This applies to anyone earning wages who has opened up such an account, regardless of how much your employer contributes. They are allowed to contribute 6% of your pre-tax income in matching funds. Not all employers will match to that level or any beyond helping you set up the account[8].

As they currently exist and for the foreseeable future, the contribution caps are somewhat higher for older workers, called “catch-up” limits. In 2009, they are set at $5,500. This amendment to the IRS code was designed to help older workers gain a large enough nest egg in plans that were started later in their working lives. This increased participation among older workers, as designed.

No matter how many different plans you have at any given time as active 401(k) tax-deferred investments, you have only one contribution cap, even if you put a portion of your limit into more than one account in a given year. If you are contributing to more than one account in a given year, you may be in danger of going over the contribution limit, which is most often dealt with by a timely transfer of funds into a different type of account, lest the IRS consider it taxable income to be reported on your annual return form.

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7 Simplified Employee Pension Individual Retirement Account

8 Individual savers without employers are required to use an IRA account when saving for retirement.

## EMPLOYER CONTRIBUTIONS

For many, the most adventitious aspect of 401(k) plans are the amount of money that your employer is allowed to invest in addition to the money you put in from your own earnings. As stated earlier, your employer is required to set up the program for you. As such, they not only dictate how much of your contribution they will match and what type of plan it is.

This does not mean that your employer is required to match your investment, only that they are allowed to do so up to a predetermined amount. They are allowed to contribute as much as 6% of your income, up to $16,500. So, for instance, if you make a large salary, the allowed percentage will be lower. Also, different plans may have lower employer contribution limits.

Sometimes, employer contributions are made in the form of shares of company stock that are purchased for the 401(k) investment plan. This is like any other type of stock purchase by a 401(k) fund manager, for the lack of plan diversity this can represent. This type of arrangement is usually considered to be more advantageous to younger workers who can make up losses due to market adjustments and losses.

## PAYROLL DEDUCTIONS AND SAVINGS RATES

For most workers with a 401(k) plans, their paycheck contributions add up to a considerable amount in even just a few years. However, when employees are offered the opportunity to save during a recession, many elect not to. Policies and regulations can influence savings rates by making it more or less advantageous for certain economic groups to participate.

The Employee Retirement Income Security Act (ERISA, section 404(c) in the IRS code) is the regulation that controls how an employer must handle the funds that are deducted from your paycheck. Under these regulations, your employer must deposit your payroll deductions into an appropriate account within 15 days of your pay date. Your employer is not allowed to hold on to the money and invest it from a business account. Monies from several employees' contributions can be combined and sent to a single fund or program, and that's just a sampling of the rules that regulate investment handling by employers.

Savings rates in the United States have been low for some time, with consumer spending propping up the stock market. As of 2007, when accounts were increasing by as much as 20% per year, as close as they were to retirement, the average Baby Boomer was still contributing less than 8% of her or his gross income into a 401(k) plan. Gen X-ers, ranging from mid-20s to mid 40s. were saving at a rate just above 6%. Their juniors were saving nearly 5% on average.

That's up from 2005, when the average savings rate of all workers was close to (or even less than) zero. While the rules that apply and encourage lower-wage earners to save for retirement in the 401(k) and other tax-deferred programs have been in place for several years by the time the economic crisis struck, these market problems and savings problems have little effect on many who earn hourly wages or are self-employed.

Since many 401(k) accounts have lost a considerable portion of their value in 2008, the rate of saving for a 50 year old worker will have to increase their savings rate, or the percentage of each check to keep on track for retirement. That does assume a long-range view of the markets, but even workers in their 20s will have to contribute more to derive sufficient gains to compensate for inflation and taxes.

## HISTORY OF 401(K) PLANS

In 1978, the tax code changed and helped create (perhaps inadvertently) the 401(k) savings plan that has largely replaced company-funded pensions.

Intended to give legal definition to the existing savings plans held by some very wealthy investors, this minor rule change led to a major financial industry and part of the market boom of the 1990s.

Since the 1980s, when the 401(k) account was introduced in a single financial organization, these plans have come to become a government sponsored private investment that is meant to help workers save for retirement in an effort to supplement their Social Security earnings. In the first six years of the program, a few hundred thousand companies were offering plans to their employees as an incentive. By the early 1990s, these savings accounts were being offered to people in nearly all types of jobs as an optional benefit.

When congress again acted in 1998 to deliberately increase 401(k) participation rates among US workers, they did so by making employee contributions the default action for all companies offering such programs. In the intervening decade, employees wishing to opt out of making 401(k) contributions have been required submit their intention to do so in writing.

## REASONS FOR SUPPLEMENTAL RETIREMENT SAVINGS

The Federal Government has had plenty of looming and emergent reasons to encourage higher rates of personal savings. One of the greatest financial challenges of the next decade is assumed to be instigated by retiring Baby Boomers. Presumably, discouraging reliance upon federal funds as a sole source of income for older people will prepare US wage-earners for loosing benefits.

Social Security benefits, in conjunction with Medicare and Medicaid, are generally not considered adequate alone for keeping one sustained above the poverty level in retirement. While many people over the age of 65 do continue to work, often it is at part-time jobs with diminished earning power. The only way to cushion your old-age, even if you don't plan to retire at the earliest available opportunity, is to save money while you're still working. Everyone would be wise to pay attention to retirement savings thing to keep inflation and market forces from stealing your prudently tucked away savings that should be rewarded with reasonable and stable, compounded returns.

Though they didn't come up with the idea themselves, the IRS and Congress realize the value of keeping money moving into markets, as well as reducing their culpability in the long-term, should Social Security become even less secure. Tax-deferment is not necessarily in a saver's best interest, but deferred money that is also part of a high-yielding investment can out-pace the creation of new taxes in the future and inflation. Getting matching contributions from your employer is always a powerful motivation, however, and that's what encourages most people to participate in 401(k) plans.

For workers who don't intend to be aggressive with their money, the 401(k) serves as a convenient way to encourage people new participants. For this mass of individual savers, their collective contributions become fodder for an IRS tax bonus when they cash out. In essence, the IRS allows a massive network of workers and businesses to invest tax revenues indirectly in the stock market for greater returns when younger workers retire in the decade and beyond when the Boomers retire.

## Inadequate Social Security Coverage

Since its inception under Franklin D. Roosevelt's administration, the Social Security Retirement Act was meant to prevent people from starving when they lost their own personal savings in old age – it was never meant to be a retirement plan, even though participation is compulsory. That's just how it was sold under protests of "Socialism" from conservative opponents.

The social security beneficiary age was set at 65 because, in 1936, was the average age of death, according to actuary tables of the era. You got to retire if you beat the odds. When passed, as a part of the larger New Deal stimulus package of regulations. As another concession, the benefits did not extend to the entire population, excluding a laundry-list of low-wage jobs.

Since that time, life expectancy has increased by nearly 20 years, and the ratio of workers contributing as compared to the number of retirees receiving benefits has decreased significantly. The likelihood of social security benefits remaining for post-Boomer workers has been threatened with extinction for several decades, but it seems certain that the benefit levels[9] after 2020 will decrease, at the very least.

## Medicare and Medicaid

Medicare and Medicaid both date back to the mid 1960s, when President Johnson signed it into law as an amendment to Social Security. Its origins can be traced back to a resurgence in poverty among the elderly. Then, as now, savings for what could be an old age of infirmity were exposed to being wiped out by banking and market problems.

Given the cost of the program now, consider that by 2030, nearly twice as many people will be receiving benefits. Efforts to privatize the medical benefits system in the early 'aughts are evidence of some support for additional health care support. It remains to be seen at the time of writing whether President Obama's campaign pledges for health care reform will come to pass, but the nature of health care payment and delivery could change significantly in the next several years.

## Cost of Living for Retirees

Inflation has an effect on savings, no matter what form they take. Any type of savings in a short-term account could be renegotiated at wildly different rate. Then again, very high inflation makes static investments[10] subject

9 proportional to the cost of living
10 that are fixed at a given rate

loosing a lot of value. By the same token, those savings are more valuable during uncomfortable periods of deflation, as those that occurred in the 1970s. Suffice it to say, maintaining the correct levels and types of investments to ensure a secure retirement is a difficult task for anyone, which is why professional input can be so useful.

Retirees who are living on nothing but their investments would do well to carefully weigh their options when considering the inflationary risks associated with long-term investments with the overall wisdom of such a scheme later in life. Many investment professionals recommend little stock exposure and more short-term investments for workers reaching retirement age.

As of the mid-00's, only about half of workers over 65 do retire, though part-time work as a sole source of income is increasingly common. This is usually done to augment retirement income from Social Security and retirement savings. Though a large proportion of retirees do own their own homes, the cost of living and utilities have a significant impact on lifestyle when funds are limited. Not to mention that vacation home that so many envision.

## LEGISLATION AND PROVISIONS CREATING 401(K) STATUS

What has become a very large part of the retirement savings of millions of Americans was actually created by a few relatively small changes to the tax code during the recession of the early 1980s. The first 401(k) program was so-named for the loophole in the tax code that a plan took advantage of. The credit for its creation is usually given to Ted Benna, a benefits consultant.

Given the task of finding a way for the employees of a bank to create a tax-deferred savings plan, he found a way to make it attractive to lower-wage workers by including the benefit of an employer contribution. Since that time, other types of tax-deferred programs have become suitable for low-and mid-wage earners, with the blessing and regulatory encouragement of Congress and the IRS.

Interestingly, the bank that this plan was crafted for decided not to do it themselves due to its never having been done before. With a perfectly good plan that was attractive to employees and encouraged investment, his own financial planning company instituted the very first 401(k) plan for its own employees.

## SIMILAR SAVINGS PLANS

There are other types of plans that help workers save for retirement in addition to the 401(k). While many are also loosing money, some are performing better during the economic crisis than others. They all share a unique way of dealing with taxation and utilize some aspect of the financial markets. There are regulations regarding who can offer these services and what investment parameters they're confined to.

### IRA plans

Also created in the 1970s, IRA saving plans provide a slightly different set of regulations that limit how an employer may contribute and the contribution limit is lower. In 2009, an earner under 50 may contribute up to $5,500 – up $500 from 2008. All IRAs are subject to contribution limits, the excess of which can also be taxed unless moved into another type of investment.

You're allowed to invest in stocks, bonds, mutual funds. Other types of more volatile funds have since been added to the list of available investment options since the late 1990s, depending upon how crafty your financial advisor is. Some plans are self-directed, while others are managed by a professional service.

There are four basic types of IRA plans as of early 2009:

- Traditional IRA
- Roth IRA
- SIMPLE IRA
- SEP IRA

The traditional IRA was introduced during the mid 1970s, when a recession caused several changes in banking regulations that were designed to stimulate investment during the mid-1970s and early 1980s. They allow for investment funds that can be more fluidly utilized as opposed to the 401(k), though contribution limits are more strictly capped. Contributions to these accounts are tax deductible but still reported as income.

Roth IRAs have been widely available since 1998. Like other IRAs they are reportable to the IRS can be used to adjust an investor’s tax bracket. Though not tax deductible when deposited, earnings are generally not taxed upon withdrawal as long as you’re of retirement age (currently set at 59½ years), with many, many stipulations. For instance, you can draw up to $10,000 out if you’re spending it on a primary residence. If you’ve had funds invested for at least five years or they’re direct contributions, you can withdraw a portion at any time.

The SIMPLE type is designed for very small businesses to easily facilitate retirement savings by a segment of the population that was deemed to be under-served by banking services. Setup fees are somewhat lower and there is only a single form to file with the IRS.

SEP IRAs are also available to self-employed workers and small businesses . In each case, the income is taxed upon withdrawal, but allowed to be deducted from earnings in the given year. This makes them an attractive option for rolling over 401(k) accounts in times of crisis, given that they save money on the “front end,” when you assume you’ll be needing extra money the most.

## Roth 401(k) Plans

Since 2006, fund managers have had the option of saving in the slightly different "Roth" 401(k) plan.  This was established by bankers after the IRS code was subtly altered to allow the combination of options found in both the more "traditional" 401(k) plan and the Roth IRA accounts that make up a significant proportion of retirement savings in the US.

Contributions are invested as an after-tax contribution, with no tax burden upon withdrawal, with the usual bevy of exceptions applying.  Contribution caps are the same as a regular 401(k) account, with the additional catch-up cap extensions for workers over 50.

## 403(b) and 457 plans

There is a similar program for people who make their money from non-profit organizations, called 403(b) plans, including the contribution cap and early withdrawal penalties.  Government workers can take advantage of another very similar plan called the 457 plan.  All these tax-deferred retirement investments operate similarly and are very often invested in the same manner.  In this case, annuity contracts may be offered through insurance company.  Church employees can invest retirement funds and teachers can create custodial accounts that are invested in annuities or mutual funds.

Unfortunately, like any other plan that invests in a fairly wide range of speculative markets, both are subject to market fluctuations just like any other 401(k) plan, depending upon how they're invested.

The same forces that affect any of the similar funds and "monetary devices" can largely be considered together, as their performance is shaped by many of the same financial considerations and conditions.  Again, if you want to analyze or change any of these tax-deferred or tax-sheltering investment plans, it's a good idea to get a second opinion from a financial professional.

# PROBLEMS WITH 401(K) PLANS

Even though 401(k) plans have become the defacto standard of retirement savings for most in the US, there remain problems with 401(k) plans that investors at all income and participation levels should be aware of.  Now that many plans have lost a significant portion of their value for the first time in many years, many employees are very seriously scrutinizing and deciding what to do with their retirement investments.

Given that the rate of saving is expected to actually decrease during a lengthy recession, the performance 401(k) accounts and the ability of fund managers to be suitably defensive or responsive, can become hindered as conditions change.  Knowledge is power.

## TRANSFERRING 401(K) EARNINGS

Transferring your 401(k) plan to a new job is sometimes problematic.  Not only is there paperwork to be deciphered and filed, along with tax messiness but, you'll also have to coordinate actions with your former employers.

It is always prudent to examine the financial climate and various options when you switch jobs, to determine whether your funds would be better left where they are.  Of course, all this takes time and effort on the part of many people who are not accustomed to expending either on speculative financial matters.  That is, of course, why so many people hire professionals to manage their investments.

If your 401(k) earnings aren't periodically transferred, you may eventually have several different plans left to various types of management. In some cases, your former employer(s) will be the only authorized management option available to you, depending upon how the account was set up. Given that most people change jobs every few years, this applies to many (if not most) investors.

You may want to roll your plan (or plans) into a single IRA or take the money out altogether. Be advised, there are penalties to pay for 401(k) plans withdrawn early, not the least of which is paying taxes on the withdrawn funds. Early withdrawal penalties can be excessive, making this option unfeasible for younger workers and those who have a relatively small amount in their retirement accounts.

## HIDDEN COSTS

What many people haven't realized until recently is that even the best-managed 401(k) programs have considerable administrative costs and fees associated with them. Though these costs were at least partially masked before when most 401(k) accounts were doing well, but capital from these accounts has always been constantly leeched off by management companies. In fact, management companies that specialize in 401(k) and similar plans sometimes skim quite a bit off the top.

Even self-directed accounts are prone to a great many fees, especially doing a lot of trading within your accounts. Some fees are necessary for covering the costs of filing with the IRS and maintaining communication with investors. They are assessed according to your particular plan or based upon your level of participation in a larger company account. Others are less scrupulous.

Ideally, one should look for an account with no "loads" or sales commissions, management fees under 1%, a turnover of fewer than half their investments each year and "12b-1" extremely low or non-existent fees that are charged for marketing purposes. These are the very sorts of costs that eat up significant portions of many accounts, especially the sales commission fees.

401(k) management fees have been climbing throughout the 'aughts, as have some of the troubling issues with account transparency.

## TYPICAL TRANSPARENCY ISSUES

Even with reporting required only once per year, fees are not always communicated well to investors or employer-customers. Usually all the fees are grouped into a single sum. While some larger companies and corporations make the effort to provide a more detailed statement for their employees, this can be difficult because there is such a loose code of laws with regards to investor-statement reporting.

There's nothing ambiguous about how the IRS handles reporting. Consider that these fees are taken right out of the capital that you're putting in, rather than the earnings. This small distinction makes a difference that has a disproportionate large effect on your long-term savings.

The Department of Labor tried to push forth legislation that would require individual fees to be clearly delineated in a separate 401(k) spreadsheet-like print out of all the different fees that go into the typical monthly administrative cost, but it was stymied. As of 2009, management companies are required to list all their various fees on an annual statement.

Sometimes your company might not be entirely forthcoming about all your 401(k) options, as many companies maintain a small portfolio of plan options for workers to choose from. This can become unwieldy and difficult to keep track of in smaller organizations that offer these options as compiled by in-house fund managers.

Keeping an eye on the money you are having skimmed right off the top of your contributions can make a huge difference when 401(k) investments are in a position where they're loosing money on a regular basis. It could mean the difference between working into your 70s or retiring with ease when you can still enjoy it.

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# WHAT WENT WRONG WITH 401(K) PLANS IN 2008?

Since the middle of 2008, the various indexes that track the price of stocks have lost between 40 and 55% of their value. In fact, nearly everything has, as the economy has “melted-down” in a fashion not seen for over seven decades. Investors that are looking for a sign of good news or, even something reasonably safe, have continued to be disappointed into the first part of 2009, with no let up in sight.

There were many things that went wrong with the market, but the bottom line is that the financial vehicles that most 401(k) programs were invested in are doing poorly. This is especially true of those that were aggressively invested in high-return/high-risk markets. More fundamental items (such as canned soup) are doing well, but soup alone does not a diversified plan make.

There is nothing wrong with 401(k) plans that wasn’t wrong with the larger system of financial markets. The market-fundamentalist approach to regulation of just what could be publicly traded with confidence that came to undermine almost the entirety of the financial markets was revealed. The consequent losses to 50 million retirement accounts is yet another painful reminder that there is no free lunch.

## THE COLLAPSE OF THE REAL ESTATE MARKET

In the middle of 2007, the price of real estate began to collapse. This was most especially true in previously "hot" markets such as Southern California, Florida and Nevada. But, it quickly became apparent in markets all over the United States then, worldwide that something was amiss. While this might have been an unfortunate occurrence without world-shaking consequences otherwise, so many people were "accidentally" invested in real estate values that were based almost entirely upon market exuberance. These were undermined almost overnight when the scale of unsecured bad loans became apparent, taking much of the value of the average person's biggest investment asset with them.

Even before the most dramatic losses in the stock market that were observed in October and November of 2008, 401(k) plans were estimated by the Wall Street Journal to have lost as much as $2 trillion dollars. Some of this value has been recovered, as of early 2009, but the markets and all corresponding physical industries have been dealt a huge blow that began when market forces caused a critical mass of mortgages to go into default. Everything just snowballed due to interconnectedness.

## THE CREDIT CRUNCH

The most immediate effect of so much money just "disappearing" overnight was to make it difficult for banks to lend. This appeared most immediately in the inter-bank lending rates as well as such economic indicators such as the Baltic Dry Index the TED-Spread[11]. It meant that real things that drove the

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11 The difference between the inter-bank loan rate and the T-bill that indicate the short-term US debt. This rate has traditionally been at between .5 and .1% and rose to over 4% in 2008

economy weren't happening as a result of frozen funds.

When people can't get money, there is a corresponding and outward-reaching cessation of spending. Large and small businesses alike have reduced operating capital to work with, shrink or close. Investments are often tied up in what are perceived as "safer" investments such as treasury-bills and precious metals.

These investments are less liquid than the vast sums of money that flow back and forth between banks, businesses and consumers, with money often staying tied up in them for months or years at a time, rather than the days and weeks of the capital market. As it becomes harder for everyone to do business and workers are laid off, there's less spending, sending the usual indicators even further along this downward spiral. In this financial and economic climate, stock prices and just about all the things that 401(k) funds are invested in continue to loose value, causing people who are cognizant of their retirement prospects to spend even less.

That some (if not many) 401(k) funds were invested in other funds that were one step removed from some petty flaky real estate dealings did not help matters one bit. As even well-regarded institutions such as Bear Sterns was found to have less actual liquidity on hand to cover investor demands, they were allowed to fail. Other banks have been, at least temporarily, patched up with a cash infusion worth hundreds of billions of dollars.

## STAGFLATION

Related to the inability of businesses and individual lenders to obtain credit, is the domino effect of lowered wages feeding into lowered amounts of capital that are available to businesses. When combined with an vast upwelling in the size of the monetary supply, conditions where inflation persists along with decreased economic growth, some economists describe the economy as suffering from "stagflation."

In such a situation, there are fewer viable options for the shock-weary investor or management company, decreasing the number of investment options for the large amounts of money that still need to go somewhere. Even with very high unemployment levels, the number of people investing will always be very large, generating trillions of dollars in “working” money that keeps the economy moving. With lower wages, there is less discretionary cash, fewer large purchases and fewer taxes or investments made as a percentage of gross income.

Sometimes stressed municipalities and states will contribute to the problem by significantly raising the fees charged to do business in their jurisdictions with increased business taxes and permit charges that unfairly target small, sleek businesses that are otherwise well-positioned to ride out any old recession. Government interaction at all levels can make the problem worse during stagflationary events.

All these forces act together to create very difficult circumstances for an economy to be driven out of in a reasonable amount of time. This is dangerous to savings plans like the 401(k) because they are liable to have their principal contributions eaten away during a long-term decline. However, assuming these conditions can’t last forever (and they always eventually move on into something else), stocks held in companies that are able to stay in business throughout the duration of the crisis will eventually regain their value. The same can be said of just about any other type of fund, even banks. The strong shall survive.

The danger to 401(k) plans in the event of a long crisis are very real and disconcerting to most.

## UNEMPLOYMENT

Because 401(k) programs are necessarily tied to employment of some type, a decrease in employment leads to a decrease in the number of people who are able to contribute.  The overall rate of savings goes down, and the services that are associated with 401(k) baking products could very well suffer.  This chokes a powerful engine that pumps investment money into markets.

Unemployment also has continued effects on the economy as a whole, generally decreasing economic growth.  This, more often than not, has the effect of decreasing the yields on investments in just about every sector, other than the more risky speculative markets.  Indeed, there aren't too many industries that are ascendant when unemployment is high.

Withdrawals on 401(k) plans can affect unemployment insurance benefits in the event of job loss.  It is not uncommon for your withdrawn investment "income" to delay the time you'll have to wait before you're eligible to receive benefits, depending upon what state you live in.  Add to this the loss of capital investment and the penalties you incur for early withdrawal, and there are quite a few reasons to leave your retirement savings alone in a difficult jobs climate.

Other plans allow for penalty-free withdrawal of a percentage of earnings, making them more attractive, even when the contribution cap is set lower. Those who are set up with both a Roth IRA and a regular 401(k) can take advantage of short-term cash withdrawals and settling into long-term rebuilding in the markets towards a retirement that, hopefully, hasn't been put too far off your original time-line.

Surely, there will be entire books written about the conditions that led to the largest loss in personal wealth that most Americans have witnessed in their lifetimes.  401(k) accounts are just one part in the massively interconnected string of ventures that got pushed a bit too far in an effort to put together the high growth rates seen though much of the 1990's and 00's.

# 3

# OPTIONS FOR 401(K) PLANS

You don't just have to let your money sit there and take this sort of pounding. You can move your retirement savings around a bit and find safe havens that will help you keep as much of your hard-earned savings as possible.

When it comes down to the nuts and bolts of self-directed fund management, often all you have to do is ask, but it helps to know the right questions to ask as well as the right people to ask those questions of.

## THE IMPACT OF A BEAR MARKET ON RETIREMENT SAVINGS ACCOUNTS

Investors reading their annual statements at the end of 2008 were collectively shocked to see just how much of their 401(k) plans had been lost in the past year. In some cases it was enough to negate the entirety of their employer contributions over the lifetime of the plan. Other people lost their jobs and their investments in company stock at the same time, as thousands of medium-sized companies and quite a few large ones went out of business entirely due to the credit pressures at the root of the most recent bear market.

There are some funds that 401(k) managers can take advantage of, specializing in decent returns in difficult markets. In the sort of volatile and decidedly bear-ish markets that have held sway for some time, these funds are able to guarantee even returns. In short, the immediate impact of a bear market on retirement savings plans of all types has caused rearrangement all over the financial landscape. This sort of action undoubtedly contributed to continued market volatility in 2008 and into 2009.

## CONDITIONS OF EARLY WITHDRAWAL

Perhaps the most common question that most people who've lost money in their retirement accounts have is whether they should consider pulling those funds out and taking the penalty, in one form or another, for early withdrawal. When one has lost their job, things are dire and there's a reminder in the mail that you've got several thousands of dollars that could get you through the next few months, it's hard not to give in. Even if your investments are just taking a pounding in a 401(k) plan, you might consider getting out of 401(k) entirely, rather than renegotiating the type of 401(k) your company is invested in.

Most often the advice of financial professionals is to keep money you have socked away for retirement in some sort of savings or investment – taking that money out to pay a mortgage, student loans or other expenses is not a very good use of investment capital funds. Sometimes your best bet, from a long-term standpoint, is to let your credit take a bit of a ding. Such funds can be thought of, to some degree, as the potential money they should be capable of generating by the time you retire. Money that is contributed by either yourself or your employer and stays in the longest, is actually worth more, after inflation of wages and prices are taken into account.

In some cases, employers may require you to contribute to the plan for a set number of years before the company contribution or stock you received in addition to your normal wage is not really yours until it's "vested." This can take from 2-6 years, on average. If you try to withdraw from the program before that time, you loose those extra contributions. This is often worth far more than the penalties and taxes on such a withdrawal, combined.

So, the conditions of withdrawing your 401(k) are also influenced by what you want to do with that money once you take it out of its original fund. Deductions for contributions are important for people who might end up owing taxes, but large losses throughout an individual or organization's portfolio might make deduction opportunities a moot point for some.

## PENALTIES

There are considerable penalties involved with the early withdrawal of 401(k) accounts, though loopholes do exist, thanks to several decades of relaxed policy and nit-picking on the part of the tax code. The penalty from the IRS for early withdrawal is 10% of the total value. If you're not old enough and haven't gone through a nasty divorce lately, taking money out of or even cashing out your 401(k) incurs a 10% penalty, payable immediately.

There are ways to withdraw small sums from a fund over time, but it requires the help of a professional to set you up with what the IRS calls "substantially equal payments." This way, you withdraw from your 401(k) as you would from an annuity, but avoiding the penalty.

If you are willing to take the penalty on a portion of the money, a less drastic solution is to take a loan on your 401(k) balance from your employer. You can withdraw the as much as half of your savings, up to $50,000. Nearly 20% of earners took loans during the relatively good times of the mid-'aughts. Since you can get into big trouble when taking out such a loan and you loose your job before it's paid back. Anyone who believes their job is anything but secure will want to take that into consideration and borrow as little as possible from this source, if possible.

Think of a 401(k) loan as the second to last resort. Often companies will limit access to this type of loan to specific categories of need as outlined by the IRS. Funerals, storm damage repair, preventing foreclosure or eviction, tuition payments, buying your “primary residence” and medical bills are among the calamities that funds are most often released for in the form of a loan from your tax-deferred plan.

TAXES

In addition to penalties, you’re now liable for paying taxes on that money, before the 10% chunk is taken out. This can be significant, but may not be payable for up to a year. If this puts you in a higher tax-bracket, it might be in your best interest to consider putting into some other type of tax sheltered savings plan.

You can get a CD at a local bank, but stimulus measures have driven interest rates down to nearly nothing, as of early 2009. IRAs, especially Roth IRAs, are especially popular investment option for a small excess of funds that might be sloshing you over into the next bracket. For most people, however, any type of savings that earns greater returns than inflation over its lifespan is at least a safe investment.

## REINVESTING IN STABLE FUNDS

Stable can be a relative term when the entire character of the market has gone into a tailspin, redefining some of the previously well-known limits and behaviors pecking order. Assumptions about what will be stable in an upcoming recession can be partially guided by past performance or speculation based upon current market needs.

Bonds are considered, by many investors, to be a very stable haven during a recessionary period. This does not include certificates of deposit (CDs) or the staggering amount of “commercial paper” that many people have become aware of for the first time in 2008. Unlike stocks, the other type of security, bond holders actually lend money rather than invest it. So, bankruptcy laws are more favorable towards lenders rather than part-owners (as in the case of stocks). Should the worst happen, you'll have first stab at the carcass that you were formerly invested in, before it's picked clean by other creditors.

Though some professionals thought dividends in the most stable companies might be safe for 401(k) investments due to the natural growth of the economy, the depth of the current financial crisis has made even this market far riskier than it's been in some time, with few companies even capable of making dividend profits to share in either stock offerings or cash payments.

One needs to be sure they don't trade stability for actually falling behind the rate of inflation which, is ultimately a loosing proposition as far as the relative value of that "money" when you finally get around to making it liquid and usable. In early 2008, when the inflation rate was around 3%, many of the most stable 401(k) funds had returns at the same rate. After administrative costs and other fees, many people (including a disproportionate number of older workers) were actually loosing money on their plans, though most didn't even realize it at the time.

Your ability to re-invest your 401(k) savings is, to some extent, hampered by the action (or lack thereof) of your current or past employer. This is addressed in more detail in Chapter 4. If you do have a certain amount of autonomy with your invested funds, there are several different factors that you want to consider when deciding on the right balance of safety and return to get through one of the biggest markets that has been seen for decades.

## EXPENSE RATIOS

The amount of money it actually costs the company that manages a fund, in proportion to the amount of money you have in your account, is the expense ratio. Charges by these companies may be as a percentage of your savings or a flat fee.

Some of the fees that companies charge are reasonable, such as the actual cost of their effort in preparing your IRS filing paperwork. But, other fees are downright outrageous – tacking on additional monthly fees that any other business would take into their overall operating budget, such as advertising fees. To make matters worse, the industry couches these fees in language that obfuscates the actual use of said charges.

Management and investor advisory fees pay those giant Wall Street salaries that seem so laughable now. As of early 2009, there's no solid word on how the incoming administration will address the ability of funds to charge such fees, given that the government is now heavily invested in those companies. Removing the loopholes that allow such graft, confidence could be restored and the system revived with a bit more balance towards consumer/investor rights.

In short, you may be getting scammed with monthly fees that have nothing to do with running a stable 401(k) fund – you'll have to find out what the fees are for before you can make a determination. That should be easier from 2009 and onward.

## AGE-RELATED FACTORS TO CONSIDER

You can retire and withdraw at least some of your 401(k) without penalty when you're 55 with the help of a good financial consultant. Boomers in their 50s will want to consider that retirement really may not be as far away as they thought. Early retirement for Boomers has the added economic bonus of freeing up jobs for younger workers who are stuck without easy access to their contributions.

Otherwise, you'll need to wait until you're pushing 60 to withdraw from your account. You don't have to take your money out of a 401(k) account when you reach that age, it's just made accessible without penalty and until death[12].

## YOUNG INVESTORS

Even if you just started your 401(k) plan, it makes more sense to keep your money invested for the long haul – something is always better than nothing. Moreover, the penalties are such that you'd be throwing away many times the future value of your contributions with each part of your early investments that are siphoned off before they have a chance to "mature."

## OLDER INVESTORS

One of the provisions of 401(k) plans that benefit older workers is the ability to contribute higher amounts per year in an effort to "make up" payments that were missed in the past. This might be due to a period of non- or self-employment. It may even be due to cashing out an old savings account or starting saving for retirement far too late in life to get the full benefit from a long-term investment[13].

Most older workers and those close to retirement will want to put their money into something that allows access, especially as jobs for older workers become harder to find. This liquidity often comes at the expense of earnings, but can be relatively safe. Short-term CDs are one easily accessible and simple way of "storing" retirement funds, as are annuities.

Investors over 50 are sure to want to consult a professional so they are sure not to be left in a difficult situation if the savings don't start to flow earlier in their dotage. This is not a good time for mistakes in management, and if

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12 Death is one of the few circumstances under which the IRS will waive the early withdrawal penalty.

13 and the miracle of compounding interest or automatic reinvestment

you’ve saved up, you can afford the consultation fee.

# 4

# A PLAN FOR STABILIZING YOUR 401(K) RETIREMENT SAVINGS

To do well and weather the economic storm that has apparently been unleashed on the markets and funds that 401(k) savings are invested in, you need to make some decisions about how your funds will continue to be invested in both the short- and long-term. It would be wise to make a plan for how you will attack the sometimes cumbersome problems associated with analyzing and adjusting your savings rate or method.

## READING AND UNDERSTANDING THE SUMMARY ANNUAL REPORT

The first thing you need to do is figure out exactly what's going on. You should have statements and contracts regarding the agreements you signed into, as well as tax returns from previous years. You can use computer programs or a pen and paper to figure out exactly where your money is going.

As of 2009, there will be a lot more information on your 401(k) report summary, including a more detailed report of the fees you pay to maintain it. Ask about any line items you don't understand and double check with your own research.

### REQUESTING UPDATED MATERIALS

Sometimes you get your fund report statements far too late in the year. You are allowed to ask for an updated statement, even if they do ding you with an additional charge to do so. You'll need current material on the performance and diversification of your fund elements to make a good decision as to whether they're a good candidate for weathering a bear market.

Fund investments can change rapidly, especially in a volatile market. Be sure your reports include historical data and some sort of standard to compare performance against that makes sense, if possible.

### ANALYZING HISTORICAL PERFORMANCE

As they always say, historical performance is no indication of future returns, but the way a fund has been managed in the past is a clue to how its investors expect it to be maintained. Check with at least 2 sources for historical performance information and see that it includes historical highs and lows over the course of many years as well as an "average" number.

## APPROACHING YOUR EMPLOYER WITH BETTER 401(K) OPTIONS

Typically, you're given some set options for how your 401(k) plan can be invested, including:

- mutual funds with stocks

- mutual funds with bonds
- money market funds
- guaranteed investments accounts or bank accounts/notes

These all have different return profiles, with stocks generally being the highest earners and both bonds and money market funds being considered reasonably safe options. Guaranteed investments such as CDs or savings accounts have the lowest returns but, are usually quite safe.

You may not have all these options at your disposal when choosing a plan to use, and the management options you're offered may be less than stellar. Feel free to approach your human resources department to discuss better options if you have them. Often employers simply want to keep their employees happy and are pleased to let you do the work on your own time, especially if it can save them money, too.

### RECRUITING FELLOW EMPLOYEES TO HELP

A number of people requesting the same changes to the financial planning of your company may be required to get anything to happen. It's often good to try crafting a letter with your own plan of action laid out in the clearest terms possible. From there, you can talk to other employees and get them to sign on, as a petition. The tone should be respectful and business-like, as well as concisely laying out objectives and means to achieve them.

## COMMON 401(K) MANAGEMENT MISTAKES TO AVOID

Some of the biggest problems with 401(k) management are the result of novices fiddling with their accounts. Once a plan is set up according to market conditions, you should be able to go a considerable while before having to readjust things. Avoiding the most common mistakes can be simple if you always keep in mind how your current actions can affect the foreseeable lifetime of the investment.

## CASHING OUT TOO SOON

Of course, the worst thing you can do with an existing account is to cash out before retirement. This is the final option for these savings, as they can be nearly impossible to replace later in your career. You should avoid this option at all possible costs.

## INVESTING TOO LITTLE TO GET MAXIMUM MATCHING FUNDS

Some companies have far more stringent rules than the IRS with regards to what you need to do to qualify for their matching funds. One common mistake is to not put a high enough percentage of your earnings into savings, decreasing or eliminating the amount of matching funds your employer will contribute.

Make sure you are clear on the company requirements for withdrawal before you sign on. Your plan should clearly state this policy, and if it doesn't, you should ask for clarification. If you've accidentally done this, make sure you make the adjustment as soon as possible.

## TAKING 401(K) LOANS

In a difficult jobs climate, it can be nearly as bad to take loans on your 401(k) as simply cashing it out and reinvesting elsewhere. The restrictions can be exacting on what you're allowed to withdraw funds for. There is an interest rate (slightly above the prime rate) that you'll be responsible for paying back in addition to the amount of principal removed from your account.

The risks you expose yourself to are too great in all bust the most secure of jobs.

## INVESTING TOO AGGRESSIVELY

Many of the losses that 401(k) plans incurred in 2008 were the result aggressive investing. The focus of some investors on unsecured debt or "junk" bonds made some plans take and a greater tumble when they all fell.

Though very few were predicting the extent of the financial crisis, but even fewer investors and financial analysts have seen anything quite like it in their lifetimes. Regardless, like in all types of investing, the more aggressively you invest into high yield funds, the greater the chance that you'll actually lose a portion of your capital investment.

## ROLLING OVER INTO IRA SAVINGS

IRAs are a popular destination for extra or old 401(k) money, though a new 401(k) plan is usually recommended for workers under 50. Some companies require you to transfer funds the moment you are no longer employed there while others will let you keep your money and/or stock holdings in their plan, indefinitely.

Rollovers can be direct or not, from one employers plan to the next. Direct rollovers require you to do nothing but sign the requisite paperwork, and no taxation is incurred. The latter can be a needlessly complicated procedure. Any procrastinator who receives a check to perform the rollover themselves may be liable for a huge tax burden if they don't deposit the money quickly enough, so caution and alacrity is cautioned when dealing with non-direct rollovers.

You also need to have an extra 20% of deposit money on hand for manual rollovers, as your employer is required to send 20% of your fund to the IRS as safe-keeping, just in case you make off with it without paying the additional 10% you'll owe if it isn't deposited within 60 days, in full. You don't get your 20% back until you file a special form with your tax return. This rule has burned many people out of 30% of their funds when they were simply trying to keep their money safe and amounts to a triple tax.