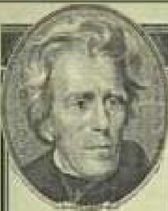

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EXECUTIVE BENEFIT PLANS, INC.
Employee Benefit & Pension Specialists

Plan Insight
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For Many Savers, Roth 401(k) Accounts are Worth Consideration

Since being rolled out in January 2006 to the cheers of most of the financial planning community, Roth 401(k) accounts have yet to gain much traction with 401(k) savers.

According to a 2009 survey by Vanguard, only 7% of those with access to a Roth 401(k) account use one. I'm convinced that the primary reasons this powerful wealth accumulation tool has been largely ignored are a lack of information and apathy.

So let's review the basics of Roth 401(k) accounts.

Anyone, regardless of age or income, can make after-tax contributions to a Roth 401(k) account if it is available.

Like a traditional 401(k) account, a Roth 401(k) account has a maximum annual payroll deduction contribution in 2010 of $16,500. If you're 50 or older, there's an additional $5,500 "catch-up" contribution allowed that brings the total up to $22,000.

Roth 401(k) contributions also are treated like traditional 401(k) contributions in terms of their eligibility to be matched by the company.

The big difference is that you receive no upfront tax deduction for your contribution to a Roth 401(k) and in exchange are allowed to withdraw all contributions and earnings free from taxation after five years of opening the account and age 59 1/2.

Think about it: a lifetime of tax-free wealth accumulation instead of building a large retirement nest egg that will be subject to the prevailing income tax rate when you decide to withdraw your savings in retirement.

Roth is Not for Everyone
The key question that needs answered is whether the value of the tax break immediately lost is surpassed by the value of the tax break you will receive

Roth 401(k) Accounts Cont'd.

when you withdraw your earnings income tax-free.

This question is not easily answered because it requires one to predict the future regarding the following three variables:

- The length of time you will leave your savings in the account.
- The rate of return you will earn.
- The difference between your tax bracket when you make contributions compared with your tax bracket when you take withdrawals.

After 3 1/2 years of meeting with 401(k) participants to discuss these difficult questions, we have identified a handful of 401(k) participant "profiles" to help guide your decision (see chart next page).

Theoretically, collecting your tax savings up front allows you to invest more and yields an identical amount of after-tax money at retirement than foregoing the deduction in exchange for tax-free distributions. This assumes your tax bracket does not change and you are able and willing to calculate the net cost difference between the two and invest the difference.

However, the vast majority of retirement savers don't go to the trouble of investing their tax savings into a traditional 401(k) account, so many are likely to be better served funding a Roth 401(k) account.

While many financial planning experts agree with this point of view, not all do. That still doesn't explain the large number of employees who have yet to consider starting a Roth 401(k) account or employers who have yet to amend their 401(k) plans to allow their employees to make this decision for themselves.

If you have not made the Roth 401(k) account available in your plan, and you and your employees fit one of the profiles in the chart (next page), an amendment will add this feature to the plan.

Roth 401(k) Accounts Cont'd.

Old school vs. new school

Savers have two kinds of 401(k) accounts to consider.

Comparison of the features of a traditional 401(k) vs. a Roth 401(k)

TRADITIONAL 401(k)	ROTH 401(k)
Pre-tax contributions	After-tax contributions
Earnings tax-deferred	Earnings tax-free*
Savings taxed as ordinary income when withdrawn	Savings withdrawn with no taxes*

** If withdrawn after account open for five years and age 59 ½*

Which 401(k) plan is right for you? These profiles may help you decide.

STICK WITH A TRADITIONAL 401(k) ACCOUNT

TEMPORARILY HIGH INCOME: Commissioned sales people can experience dramatic swings in income. If you are having an unusually productive year, you may benefit more from the tax deduction in a high tax year provided by a traditional 401(k) contribution than the deferred benefit of tax-free earnings.

SHORT-TERM RETIREMENT SAVER: In the short-term, the upfront tax deduction for your 401(k) contribution is almost always more valuable than tax-free treatment of earnings on your savings.

CURRENTLY QUALIFY FOR CERTAIN INCOME TAX CREDITS: Shifting from pretax to after-tax saving could bump you into a higher tax bracket and put certain tax credits at risk.

UNSUCCESSFUL SAVER: If saving for retirement has just not been a priority of yours, you may be better off with the upfront tax break than paying more taxes today in exchange for tax-free distributions on a limited amount of retirement savings.

CONVINCED U.S. TAX CODE WILL CHANGE: If you believe that the U.S. tax code will shift away from its emphasis on the taxation of current income, a known tax break today may be worth more than the promise of a tax break of unknown value in the future.

CONSIDER A ROTH 401(k) ACCOUNT

LOW TAX BRACKET TODAY: Many American workers find themselves in a low (less than 15%) tax bracket and are well-advised to lock in this historically low tax rate by contributing after-tax dollars today in exchange for tax-free distributions in retirement.

YOUNG AGGRESSIVE INVESTOR: Those with more than 30 years to go until retirement who plan on staying invested aggressively to maximize their long-term rate of return are likely to retire with significantly more investment earnings than contributions. Sheltering the earnings from taxation is a sound strategy.

WEALTHY INVESTOR: Someone with substantial savings already accumulated in tax-deferred accounts may desire to shelter future savings past age 70 ½, or pass wealth on to beneficiaries income tax-free.

MAX CONTRIBUTOR: If you can afford to contribute the maximum each year, Roth allows you to build a larger benefit in your 401(k) account for retirement because you are contributing after-tax dollars.

WORK FOR A COMPANY WITH GENEROUS COMPANY CONTRIBUTIONS: All company contributions to your retirement account are made with pre-tax dollars and are therefore subject to taxation upon withdrawal. To protect against the risk of a higher taxes in retirement negatively impacting your retirement savings, contribute to a Roth account to diversify your tax risk.

ERISA Fidelity Bonds – What to Think About, What to Look For

The Employee Retirement Income Security Act of 1974 ("ERISA") requires that all persons who "handle" funds of retirement and welfare plans be bonded. The purpose of the bond is to cover losses that a plan incurs as a result of a fraudulent or dishonest act of a "plan official"—someone who handles plan funds. The bond is typically required to have limits equal to 10% of the value of the plan's assets, with a maximum of $500,000. There are exceptions to this general rule, including the situation where more than 5% of the plan's assets are "non-qualifying" assets, such as real estate limited partnerships. In that

ERISA Fidelity Bonds Cont'd.

situation, the bond limits must be 100% of the value of the plan's non-qualifying assets.

As a practical matter, most plan sponsors are referred to a surety company (perhaps by a third party administrator or another service provider). The bond company then sends out a relatively simple application and, when it receives answers to the questions on that application, issues a bond. Perhaps more often than not, the plan fiduciaries never read the bond and have no idea what losses the bond covers or whether the persons who caused the loss are covered by the terms of the bond.

Fiduciaries who take such a hands off approach are making a mistake. One of the functions of a fiduciary is to be sure that the plan is properly bonded. If a plan secures a bond on the fiduciary's watch, then sustains a loss that the bond—by its terms—doesn't cover, the fiduciary could be on the hook for the amount that the plan would have received if the fiduciary had obtained a bond that covered all of the persons and losses that it needed to cover. Consequently, plan fiduciaries should not simply take it for granted that a bond will cover everything and everyone that it needs to cover. Since ERISA requires that fiduciaries act prudently in carrying out their duties, one of the things that fiduciaries should put on their "must do" list is implement a process to evaluate the bond.

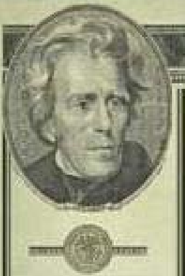
As part of that evaluation process, fiduciaries should get answers to the following questions:

Who Is "Handling" Plan Funds?

ERISA requires every person who "handles" plan funds to be bonded. A person is considered to be "handling" plan funds if he has the ability to cause a loss to the plan through a fraudulent or dishonest act. For example, any person who has the ability to sign checks on a plan account is "handling" plan funds in doing so (and this may include independent contractors). If a fiduciary has not thought through who may handle the plan's funds, he may not be in position to determine whether a bond offers the necessary coverage.

Whose Acts Are Covered By The Bond?

Once the fiduciary determines all of the



persons who are handling or may handle plan funds, he needs to review the bond itself to determine whether, by its terms, the bond will cover losses caused by all of those persons. In this regard, a good starting point may be to determine whether the bond covers losses caused only by persons specifically identified in a schedule attached to the bond (a so-called "name schedule" bond), or rather, whether the bond covers losses caused by all persons—subject perhaps to certain excluded classes of persons—regardless of whether they are specifically identified on the face of the bond or not. This latter bond is often referred to as a "blanket bond."

Keep in mind that while a blanket bond may cover losses covered by a broader group of people, it is possible that a "name schedule" bond may offer a plan greater protection. (This may occur, for instance, if the name schedule bond provides coverage for losses the plan incurs due to the dishonest acts of two persons identified in the bond acting in concert with each other. Depending on the terms of the bond, in this example, the bond may cover losses up to the bond's limits with respect to the acts of each of the dishonest plan officials.)

Are Other Bonds Available That Provide Greater Coverage?

There is more than one bond company that offers bonds to ERISA-governed plans and not all bond forms are alike. Fiduciaries should consider reviewing multiple bond forms and seeing whether and how they differ with respect to the scope of the coverage they provide.

Are Persons Who Are Not Covered By the Bond Covered By A Separate Bond?

Gaps in coverage may exist under a plan's bond, particularly in the context of a "name schedule" bond. For example, a plan may delegate discretionary investment management to a third party who is not employed by the plan sponsor, but who has control over plan assets. If that person is not identified on the bond's "name schedule," losses he causes may not be covered by the bond. In that case, the plan sponsor has at least two alternatives. First, it can try to get the bond company to cover the investment manager's acts. Second, the plan

fiduciaries may inquire of the investment manager whether he has secured or will secure a separate bond that covers him if he causes losses to the plan due to fraud or dishonesty. Fiduciaries are within their rights to ask those persons to secure an appropriate bond to cover their actions with regard to the plan.

Stress test your fiduciary focus: Are you following best practices?

For plan sponsors, the fiduciary standards of ERISA are among the highest the law recognizes. Plan fiduciaries are held to an exceptional level of accountability under the law, including the assumption of personal liability for fiduciary decision-making.

Meeting the standards for fiduciary conduct is vital for many reasons, and perhaps foremost among them is the simplest reason of all: It's the right thing to do—for your plan and for your participants.

In today's environment, devoting your attention to meeting your fiduciary responsibilities is even more vital. Vanguard can act as your partner in educating your committee about fiduciary best practices. Vanguard Strategic Retirement Consulting (SRC) has a team of dedicated resources, including ERISA attorneys, senior benefits consultants, and actuaries, that provides training and regular updates regarding regulatory and legislative developments in this important area of law.

It's important for every plan fiduciary to be aware of key obligations and duties.

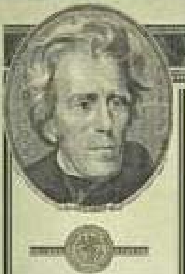
Top things to keep in mind:

Plan fiduciaries have the following duties:

- Act for the exclusive purpose of providing benefits to participants and defraying reasonable expenses of administering the plan.
- Act with care, skill, prudence, and diligence.
- Diversify investments to avoid large losses.
- Follow the terms of the plan.

To fulfill your fiduciary duties, plan sponsors should implement these critical best practices:

- Hold regular committee meetings—and call special ones when necessary. It's



important to have the necessary experts at the table with you and to document your decisions—even when the decision is to maintain the status quo.

- Maintain a well-drafted investment policy statement (IPS). All plans benefit from having an IPS that can serve as a road map to guide fiduciary decision-making with respect to plan investments. Once a policy is created, it's extremely important that plan sponsors follow the terms within the IPS.
- Understand fees—and ensure that they are reasonable. Sponsors should not only look at out-of-pocket and recordkeeping fees, but also examine investment costs that go along with each investment in the fund lineup.
- Focus on decision-making. It is critical to maintain a prudent, deliberative, effective, and well-documented decision-making process.
- Oversee plan administration. Sponsors should ensure that the administration of the plan conforms to the written plan document and any administrative policies and procedures for the plan.

Additional fiduciary best practices:

- Satisfy ERISA 404(c) regulations. In defined contribution plans, section 404(c) of ERISA relieves plan sponsors from fiduciary liability for participant investment decisions if certain requirements are met. Plan sponsors still have to prudently select and monitor the funds within the lineup, but they are relieved from liability for the individual investment choices participants make.

In addition, plan sponsors should consider adopting a qualified default investment alternative (QDIA). Plan

sponsors will have fiduciary relief when participants are properly defaulted into a target-date fund, and the sponsor fulfills the other QDIA requirements.

- Mitigate company stock risk. Company stock remains the single biggest fiduciary threat to plan sponsors. To manage that risk, ensure that your investment committee members act solely in the best interest of plan participants in determining the prudence of offering company stock as an investment option. Also ensure that your participants receive information about the risks of investing in a single security.
- Offer sound investment tools, including advice. Offering low-cost fund options, target-date funds, education, and robust advice programs are some very important ways that plan fiduciaries can help their participants make sound investment decisions.

"In the current environment, there are a number of factors that make it an ideal time for plan sponsors to revisit their fiduciary practices," said Sherryann Plessé, principal in SRC. "The market environment, the threat of participant lawsuits, and the ever-changing regulatory landscape really make it an ideal time for plan sponsors to step back, reassess their current practices, and see if there are areas where they might be able to tighten things up."

Establishing and executing a few key fiduciary best practices can help your committee fulfill its fiduciary obligations under ERISA.

Notes:

- Investments are subject to risk.
- Diversification does not ensure a profit or protect against a loss in a declining market.

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