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Employee Benefits Update

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Is your retirement plan successful?

Which criteria tell the real story

If you gave your retirement plan a report card, what would it look like? Does it do the job of preparing your participants for retirement? And how do you benchmark your plan's performance? Let's take a closer look.

Defining criteria

First, a quick reality check: What criteria do you already use to benchmark your plan's performance? Traditional measures such as fund investment performance relative to a peer group, the breadth of fund options, benchmarked fees, and participation rates and average deferral rates (including matching contributions) are critical. But they're only the beginning of the story.

Add to that list helpful administrative features and functionality, including auto-enrollment and auto-escalation provisions, investment education, retirement planning, and forecasting tools. In general, the more, the better.

> *Unless you have an older workforce and participants are retiring and rolling their fund balances into IRAs, look for a healthy overall asset growth rate.*

A sometimes overlooked plan metric is average account balance size. This matters for two reasons. First, it provides a first-pass look at whether participants are accumulating meaningful sums in their accounts. Naturally, you'll need to weigh that number in light of the age of your workforce, and how long your plan has been in existence. Second, it affects recordkeeping fees — higher average account values generally translate into lower per-participant fees.

Knowing your plan asset growth rate is also helpful. Unless you have an older workforce and participants are retiring and rolling their fund balances into IRAs, look for a healthy overall asset growth rate, which incorporates both contribution rates and investment returns.

What's a healthy rate? That's a subjective assessment and you'll need to examine it within the context of current financial markets. A plan whose assets shrank during the financial crisis a decade ago could hardly be blamed for that pattern. Overall, however, you might hope to see annual asset growth of at least 15%.

Keeping participants on track

Ultimately, however, the success of a retirement plan isn't measured by these discrete elements, but by aggregating multiple data points and others to derive an "on track to retire" score. That is, how many of your plan participants have account values whose size and growth rate are sufficient to result in a realistic preretirement income replacement ratio, such as 85% or more?

Retirement preparedness: A national perspective

A large survey published early this year by Fidelity Investments offers some perspective about participants' retirement readiness. Here's a recap of the 2017 "America's Retirement Score" report based on the survey's four preparedness groupings:

On target. About one-third (32%) of American households fall into this category. Being on target means being on track to cover more than 95% of projected expenses in retirement.

Good. This group, defined as heading toward a capacity to cover 81% to 95% of their estimated expenses in retirement, comprises 18% of working American households. They'll likely be able to cover essential expenses, but not discretionary ones such as travel and entertainment.

Fair. Slightly more than one in five (22%) are projected to be able to cover 65% to 80% of their expenses. Unless they improve their statuses, they'll need to make "modest" lifestyle adjustments in retirement.

Needs attention. At 28% of American households, this group is the second largest, behind the "on target" group. Projected to cover less than 65% of their expenses, these people will need to make "significant" downward lifestyle adjustments to cover their expenses.

By generation, the largest "on target" cohort is Baby Boomers, in part because greater numbers of them are covered by traditional defined benefit pensions. Their average score is an 86. Gen X and Millennials are essentially tied at 77 and 78 ratings, respectively, according to the report.

It might not be possible to determine that number with precision. Such calculations at the participant level, sometimes performed by recordkeepers, involve sophisticated guesswork with respect to participants' retirement ages and savings outside the retirement plan, as well as their income growth rates and the long-term rates of return on their investment accounts.

Communicating with participants

So, after you analyze how your participants are doing, what can you do with the data? The most important thing is communicating each employee's "on track" status directly and urgently to him or her.

A study by Empower Retirement, a retirement plan recordkeeping company, found, perhaps not surprisingly, that many retirement savers begin to increase their deferral rates when told their on-track statuses, expressed as an income replacement percentage. This preparedness metric proved to be significantly more motivational than merely being reminded of their account balances and growth rate.

Once you've given your participants their individual "on-track" statuses, you can also point them to tools that can generate projections of the impact on their on-track statuses of adjustments to their deferral rates. A sophisticated modeling tool would also project different forecasts based on varying asset allocation mixes.

Now what?

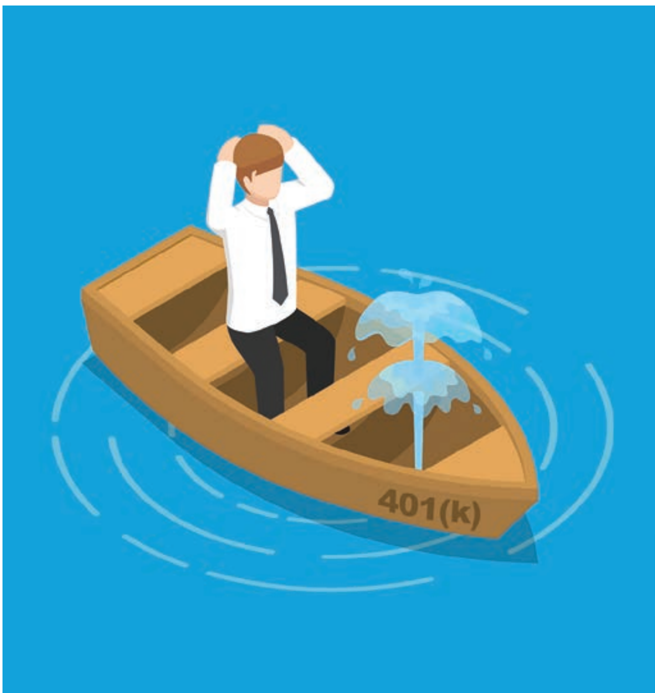
It's unrealistic to expect a comprehensive on-track analysis to reveal that all your plan participants pass the test with flying colors. What's important is finding and adjusting the right levers to increase your plan's performance each year. Also, while doing so, it's still critical to keep your eye on the ball with respect to the full range of fiduciary duties attendant to sponsoring a retirement plan. □

Stem plan leakage by upgrading your 401(k) loan rules and practices

Has your 401(k) plan sprung a leak? If so, it's better to patch it than just trying to paddle faster to get to shore. "Plan leakage" refers to participants allowing their account balances to shrink, because of either loans or hardship withdrawals. Plan loans don't always result in permanent leakage when they're repaid, but they still can have adverse long-term consequences for participants.

How do plan loans leak?

There are several basic problems participants can run into with plan loans. For example, while participants are "paying themselves" with the plan loan interest, typically there's an opportunity cost associated with not having borrowed funds invested in financial markets, as they would otherwise be if they remained in the plan. In addition, making principal and interest payments on the loan typically constrains participants' ability to maintain the pace of their previous salary deferrals.



Many participants ultimately default on plan loans, resulting not only in adverse tax consequences, but diminished retirement savings. Finally, from the sponsor's perspective, plan loans increase overall plan administration costs to the ultimate detriment of plan participants.

Why allow plan loans?

None of this is to suggest that having a plan loan provision — which is entirely optional — is a bad idea. Most plans do allow loans. Why?

Many participants ultimately default on plan loans, resulting not only in adverse tax consequences, but diminished retirement savings.

The fundamental reason is to encourage plan participation by the full demographic spectrum of employees who might otherwise not join the plan, fearing that they would essentially lose access to their savings without the ability to borrow from their accounts. Also, when employees encounter a financial emergency and have to borrow money, they can probably do so at a lower cost through a plan loan, particularly when factoring in the interest payments that will accrue to their own accounts. Similarly, an employee who's carrying high interest rate loans would probably come out ahead in the long (and short) run by paying off that debt with a plan loan.

In addition, if an employee with shaky personal finances can't access credit at a reasonable cost from

other sources, a financial crunch could drive him or her to take a hardship withdrawal — a welcome form of relief during a difficult time (though a leading contributor to plan leakage).

How can you plug leaks?

How, then, to strike a balance between maximizing participation with a plan loan provision and the unintended consequence of plan leakage? Consider the following:

Incorporating preemptive education. Instead of just explaining plan loan procedures, incorporate financial education into the material that plan participants must read before requesting a loan. Such content might include a list of good (retiring higher-cost debt) and bad (discretionary purchases like expensive vacations) reasons for borrowing.

Limiting the number of allowable plan loans. IRS rules cap loan amounts at the greater of $10,000 or 50% of the participant's vested account balance, *or* $50,000, whichever is less. The rules don't, however, limit the actual number of loans participants can take out if the total amount borrowed stays within those limits. But the more loans employees can take out, the easier it might be for them to wind up hitting the aggregate debt ceiling.

Charging loan origination fees. Research confirms that the higher the loan fee, the fewer participants with an outstanding plan loan. According to an Aon Hewitt study, 28% of participants have outstanding loans when the fee is below $50, but only 20% do when the fee is $100 or more.

Setting additional plan loan limits. Employers can further limit loan amounts, for example, with a loan limit formula based entirely on employees' accumulated deferrals, but not amounts reflecting your matching contributions. Other limits include requiring that, once a plan loan is paid off, another loan cannot be taken for a period of time; setting a minimum loan requirement; and limiting the reason for a loan to the same requirements that hardship distributions have.

Tightening things up

Another leak-plugging tactic you can employ concerns the loan principal and interest payment process. Putting it on a payroll deduction basis should help ensure loans are retired as promptly as possible. These tactics, adopted in a coordinated manner, should amount to more than a duct tape solution to plan leakage. Integrating them into a larger participant long-term financial education and retirement readiness campaign can go a long way toward tightening up participants' accounts. ☐

Compliance Alert

Upcoming compliance deadlines:

6/30* Deadline for processing corrective distributions for failed actual deferral percentage / actual contribution percentage (ADP/ACP) tests from plans with eligible automatic contribution arrangements (EACAs) without 10% excise tax

7/29* Summary of material modifications is due (210 days after the end of the plan year in which the amendment was adopted)

7/31 Form 5500 is due for calendar year plans or a request for an extension on Form 5558

7/31 Form 5330 to report excise tax on prohibited transactions and excess 401(k) plan contributions is due

7/31 Form 8955-SSA for calendar year plans to report separated participants with a deferred vested benefit, unless an extension is requested

** These due dates fall on the weekend this year. The IRS historically hasn't extended due dates for required disclosures, contributions or distributions.*

Plan documents: Be proactive to defuse possible landmines

Sometimes overseeing a retirement plan might feel like navigating a minefield. With proper precautions, however, you can get through safely. Case in point: Making sure your plan is operating consistently with its plan documents.

ERISA requirements

Although running your plan consistently with plan documents might sound like a straightforward proposition, this isn't always the case. As a reminder, ERISA requires plan fiduciaries to discharge their duties solely in the interest of participants and their beneficiaries "in accordance with the documents and instruments governing the plan."

ERISA's mandate requires employers to know the directives of their plan documents and run the plan accordingly.

An employer defending itself in a recent class action suit primarily involving alleged violations of the Fair Labor Standards Act was blindsided by an accusation that it had also violated ERISA. How? Because the disputed wages were "eligible compensation" under the employer's retirement plan, as described in its plan document, ERISA applied as well.

Applicable documents

ERISA's mandate requires employers to know the directives of their plan documents and run the plan accordingly. To do so, you must first confirm that your plan documents are ERISA-compliant.

Underlying those two imperatives is the assumption that you know which documents are the governing "plan documents." There's no doubt that the core document explaining how the plan operates comes under this heading, but you may have other written pronouncements tucked away that could be deemed plan documents in litigation.

For example, investment policy statements, as well as plan loan and qualified domestic relations order procedures, might also be plan documents if audited or subjected to legal scrutiny. Even an unsigned plan amendment might. While of course you wouldn't knowingly write a document that violates ERISA, inconsistencies could easily arise if you don't subject it to the same level of review as a core plan document. Ask your attorney to look at all such items and help you decide which ones are plan documents.

Also, don't draft documents, such as investment policy statements, because you think you should, but then not actually follow them. What would be worse: having a document, such as an investment policy statement, and not following it or not having one at all? It'll be a case-by-case determination.

And here's another sobering reminder: The IRS Employee Plans Compliance Resolution System won't necessarily get you off the hook with respect to plan document violations involving a fiduciary breach that causes financial harm to the plan. That's because such matters generally fall under the purview of the Department of Labor, not the IRS.

An ounce of prevention

As you review your various policy statements, consider explicitly and legally identifying which ones are plan documents and which aren't. Doing so will not only ensure that everything's ERISA-compatible, but also prevent you from inadvertently making promises that you can't keep. ◻

Using targeted education to narrow the gender gap in retirement savings

In employment settings in which women save less for retirement than men, an aggressive educational program can help to narrow the gap. That's the conclusion of a recent study from the Center for Retirement Research.

The study

The study focused on the impact of an initiative by the state of Wisconsin to close a retirement savings gender gap among state employees. Although Wisconsin state employees were also covered by defined benefit plans, increasing women's contributions to a state-sponsored supplemental retirement plan was considered essential to their retirement security.

The study's authors reported that, while financial education outside of the workplace typically doesn't correlate with increases in retirement savings, workplace-based education efforts generally are effective. The Wisconsin initiative "delivered information, motivation, and challenges through multiple media over a span of a few months." For example, women received monthly emails with messages such as "women are twice as likely as men to live in poverty during retirement," with links to online educational resources and financial planning tools. Such messages apparently hit home.

Women were also invited to attend women-only lunchtime education sessions, and the resulting participation rates were high. Rather than lectures, the program format emphasized peer interaction to overcome what the study's authors call "the ostrich effect" — a reluctance of people to discuss personal finance matters, especially if they're already worried about their financial health. Program content directed participants to take specific actions to improve their financial outlook, particularly increasing their participation in the supplemental retirement savings plan.

The results

According to the study, "Differences between men and women in financial knowledge and motivation contribute to gender gaps in retirement savings." However, the study concluded that using multimedia financial education can increase knowledge and motivate participants. ◻

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Pension auditors must sift through enormous amounts of financial data in accordance with the requirements of numerous laws, regulations and professional standards. If they don't know what they're doing, they can easily get lost in the numbers, run up large fees and fail to provide an accurate assessment of a plan's financial status.

Pension audit specialists

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Insero & Co. is the independent registered public accounting firm for many companies that file a form 11-K with the Securities and Exchange Commission. We currently perform audits for more than 150 plans ranging in size from 100 to 60,000 participants, and from $1 million to more than $10 billion in assets.

Big firm capabilities, small firm attentiveness

As our many satisfied clients will testify, we offer the comprehensive benefit services of a large national firm, but at less cost and with a higher level of service. With more than 125 accountants, professional consultants and support staff, our firm is large enough to bring robust resources to bear on almost every client need, yet small enough to provide the personal attention and relationship-based service that is important to our clients.

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