YEAR END
2018

Employee Benefits Update

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It may be time to offer a self-directed brokerage account option

Self-directed brokerage accounts (SDBAs) within a 401(k) plan typically offer participants the ultimate investment smorgasbord: a virtually unlimited selection of stocks, bonds, exchange traded funds (ETFs), and mutual funds to feast on. Yet relatively few sponsors — only 16% of plans on the platform of one of the largest 401(k) recordkeepers — offer them.

Pros and cons

If you don't currently offer a brokerage option, you might at least consider the pros and cons of doing so. Ruling it out instinctively could be a disservice to plan participants, whose interests you're charged with safeguarding.

The most common argument against offering SDBAs is the concern that participants electing to use them will make unwise investment decisions, overloading on "hot" stocks that crash and burn promptly after they invest. But is that father-knows-best approach consistent with your operating philosophy? And, more to the point, is that worst-case scenario probable?

The principal argument in favor of offering an SDBA option is this: Plan participants should have the chance to create a customized retirement portfolio. Some have enough financial knowledge to assume the responsibility of either making their own detailed investment decisions, or retaining a professional investment advisor to assist them with the task. Some participants, particularly the older ones and those with substantial account balances, may indeed benefit from investment opportunities not available to them under your existing array of options.

The counterargument that participants can, if they want to buy individual securities, do so on their own outside of the 401(k) plan is valid only when those participants have substantial savings outside the 401(k). Even relatively wealthy participants often have most of their investable assets held within their qualified retirement plans.

An additional argument for SDBAs is that, when participants are defaulted into qualified default investment alternatives like target date funds, inertia takes over and they typically stick with that arrangement. That means that participants who would actually switch assets to an SDBA may be limited to those who are particularly motivated to exploit the opportunity. Casual investors wouldn't simply drift into an SDBA. Plus, you can limit the proportion of funds that participants can transfer into one.

SDBAs by numbers

Some market data is available that gives an indication of the kind of participants who, when given the opportunity, move funds to self-directed brokerage accounts (SDBAs). For example, Vanguard examined the topic by looking at its own customer base.

Among its findings:

- The median age of participants using an SDBA is 52, vs. 46 for all participants.
- The median 401(k) plan account balance for SDBA users was $262,446, vs. $29,603 for nonusers.
- SDBA users' median equity allocation (83%) was the same as that of other participants.
- Half of 401(k) plans with an SDBA option imposed a cap on the amount of funds participants can invest through their SDBA.

The Vanguard study found that 94% of participants had some cash in their SDBAs, and the most common holdings were mutual funds, followed by stocks.

Fiduciary considerations

In any case, choosing to offer a brokerage option is a fiduciary decision for sponsors. This requires plan sponsors to ask:

- Would an SDBA give participants an opportunity to craft retirement portfolios in a way that they cannot with our existing investment lineup — that is, would it actually fill a gap?
- Are a significant number of participants interested in having this option?
- Is it probable that participants are sophisticated enough either to rationally choose investments or to engage a registered investment advisor to support them in their investment selection decisions?
- Are brokerage services available that the plan can incorporate and that have a good track record for service quality and competitive fees?
- Would participant brokerage assets be properly held in secure accounts?

Only after carefully reviewing these issues and speaking with your employee benefits attorney should you consider moving forward with an SDBA option.

Ongoing monitoring

If you do add an SDBA, you'll have the same ongoing monitoring duty for that option as for others in your plan. According to a Department of Labor (DOL) "field assistance bulletin," fiduciaries must periodically review, among other things, any changes in the information that served as the basis for the initial selection of the provider. This includes determining whether the provider meets both applicable federal and state securities law requirements.

However, under the DOL's 404(c) regulations, you wouldn't be held accountable for poor investment decisions made by plan participants — as is the case with other plan investment options — provided that you've given participants a "broad range" of choices, as described in those regulations.

Encouraging participants

If you decide to add an SDBA option, consider encouraging participants who select that option to create their own investment policy statement, just as plans and fund managers do. If they follow through, the exercise could help them make the most of the SDBA opportunity, and avoid its potential pitfalls. □

Compliance Alert

Upcoming compliance deadlines:

12/1* Deadline for 401(k) and (m) safe harbor notice, annual qualified default investment alternative (QDIA) notice, and qualified automatic contribution arrangement (QACA) notice (can be made up to 90 days before the start of the plan year)

12/15* Extended deadline to distribute the Summary Annual Report for plans that filed Form 5500 by October 15 (calendar year plans)

12/31 Deadline for making required minimum distributions for 2018

12/31 Deadline for making corrective distributions for failed 2017 actual deferral percentage (ADP) and actual contribution percentage (ACP) tests with a 10% excise tax penalty, as well as for making a qualified nonelective contribution (QNEC)

12/31 Deadline for making a prospective amendment to add or remove safe harbor status for the 2019 plan year

12/31 Deadline for making a prospective amendment to add eligible automatic contribution arrangement (EACA) and QACA for the 2019 plan year (must give participants notice at least 30 days prior to the effective date)

1/31 2018 Forms 1099 are due to participants

** These dates fall on a Saturday. The IRS historically hasn't extended due dates for required disclosures, contributions or distributions.*

Is there a "MEP" in your future?

Streamlined retirement plan model under review

For small employers, the costs of administering a retirement plan can be intimidating. Legislation in Washington could provide some relief — particularly for very small employers — by easing regulatory restrictions covering "multiple employer plans" (MEPs).

Regulating MEPs

A MEP is, in effect, a plan of plans. It's a common administrative umbrella covering plans sponsored by a group of small employers. Current rules governing MEPs require, among other things, that the companies joining together to form a MEP have a "commonality of interest." This is generally met when the companies are members of the same industry. For example, members of a national association would have the commonality of all being members in the same industry and members of such association. If the association sponsors a retirement plan, it would allow members to participate in such plan. These arrangements have typically been known as "closed" MEPs.

The primary aim of the MEP changes is to inspire small employers that currently don't offer a retirement plan to do so.

In addition, current IRS regulations appear to suggest that regulatory violations by a single employer in a MEP become the liability of all of the plans within the MEP. Naturally, employers are skittish about using a MEP under these circumstances.

Legislation and regulatory proposals to address those issues have been proposed by both Democrats and Republicans. Former President Obama's administration encouraged the enactment of such a law in 2016, but it didn't happen. Now, the Trump administration is proposing similar changes. In late August 2018, President Trump issued an executive order calling on the Department of Labor to, among other things, examine policies that would clarify and expand circumstances under which U.S. employers may sponsor or adopt a MEP. The "commonality of interest" requirement is one of several constraints targeted to be eliminated from the requirement. Another is the liability issue.

Congress' failure to move forward on earlier proposals may have been more due to distraction than widespread opposition to the idea of expanding MEP eligibility. But now, a bundle of bills has been introduced, known as Tax Reform 2.0. The package includes the Family Savings Act of 2018, which would, among other things, expand MEP eligibility and thereby accomplish by statute what the Trump administration was seeking to address through regulation.

The primary aim of the MEP changes is to inspire small employers that currently don't offer a retirement plan to do so. According to a study by the Government Accountability Office, only 14% of employers with 100

or fewer employees sponsor a retirement plan. (That includes many companies with 10 employees or fewer.)

Closing retirement coverage gap

The Department of Labor (DOL) requested input on the issue and one of the commenters was Prudential Insurance Co. It stated that it has "long believed that multiple employer plans offer a potential solution to closing the retirement coverage gap." But easing the MEP rules doesn't exclude the possibility that some employers, which already have a plan in place, might find a MEP a more efficient alternative — and make the switch.

It's noteworthy that the Trump administration has already been able, by regulation, to allow more employers later in 2019 to create MEP equivalents in the health arena, known as Association Health Plans (AHPs). Prudential, in its letter to the DOL, pointed out that the same potential benefits from AHPs could apply to MEPs, such as "increased bargaining power, economies of scale, administrative efficiencies, and transfer of plan maintenance responsibilities from participating employers."

Looking ahead

Until the liberalization of current legal constraints on MEPs actually occurs and service providers begin to introduce them to the retirement plan sponsor community, it won't be clear how attractive they might be. If you're a small employer, be sure to ask your benefits advisor about whether a MEP may be right for your company. ◻

Not planning for early retirement threatens employees' financial security

Employees often are unfazed by retirement calculators or other recommendations telling them they'll need to step up the pace of their retirement savings to retire at a "normal" age. The Employee Benefit Research Institute's (EBRI's) latest "retirement confidence survey" compared what employees say their retirement timing plans are to when people in general (not the same people stating their intentions) actually do retire.

Just the facts

While many participants believe they'll continue to work past retirement age, nearly half (47%) of retirees retire sooner than expected, according to the survey. The survey found that over three-quarters (78%) of active workers who reported a change in their anticipated retirement date pushed back the time they expect to retire. Thus, it can be a risky assumption for participants to make, based on the data.

EBRI's survey found that workers report a median anticipated retirement age of 65, while retirees report they retired at a median age of 62. Nearly one-third (31%) of surveyed workers expect to retire in their 70s or beyond, or not at all, vs. only 7% of surveyed retirees who did so.

Notably, only 3% of surveyed retirees reported that they had retired *later* than they had originally planned. That figure has drifted downward since a high of 9% in 2012, in the wake of the financial crisis.

The bottom line: "A considerable gap exists between workers' expectations and retirees' experience," according to EBRI.

A little reasoning

The most common reasons workers give for their plans to delay retirement are financial. Reasons included workers who:

- Believed they couldn't afford to retire,
- Lacked faith in Social Security,
- Feared health care costs, and
- Wanted to make sure they have enough money to retire comfortably.

The primary reason given for people leaving the workforce earlier than planned was a health problem or disability. But a fortunate 24% cited the fact that they could afford to retire earlier than expected as the reason.

Should this disconnect matter to you, as a plan sponsor? The answer is probably "yes." A common concern among some employers is that undersaving employees will remain on the payroll beyond their most productive years, not that they'll retire prematurely.

As an employer, you want productive, engaged employees. When employees know you're genuinely concerned for their welfare, they're more apt to be committed to doing their jobs well. Keeping employees informed about matters that could have a significant impact on their lives is one way to demonstrate your concern.

When you motivate employees to save at a pace that allows them to retire at a normal age — or even sooner — and they maintain that pace, their anxiety level over their personal finances shouldn't be a source of distraction at work. Finally, as a plan fiduciary, you're charged with safeguarding the interests of plan participants. While it's unlikely that you could be sued for failing to inspire, cajole or otherwise cause participants to save adequately for retirement against their will, the spirit of fiduciary responsibility under ERISA might suggest you try your best anyway.

What to do

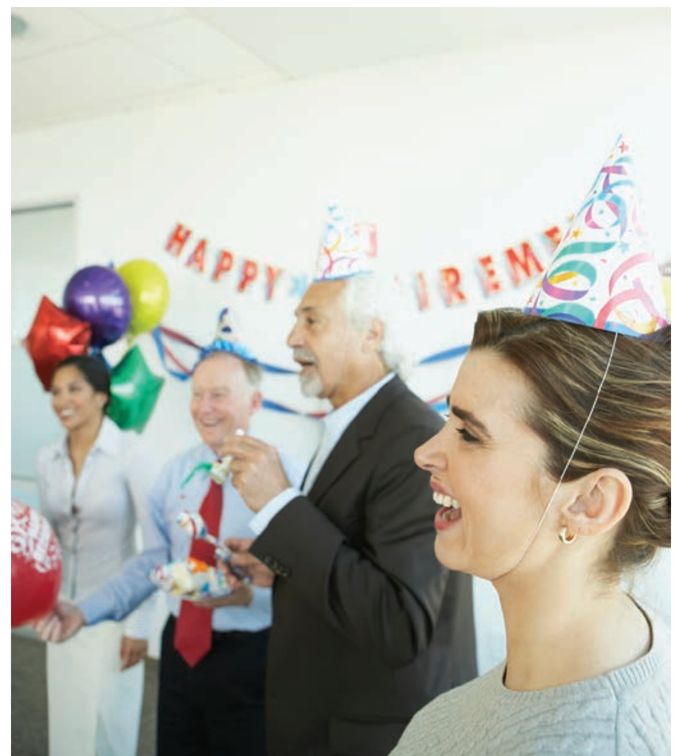
This all means you should follow your participant communication best practices. Simple and direct messages, presented in multiple communication channels, work best.

A bold statement like: "You might be retiring sooner than you think. That could be a problem" or "Postponing retirement? Don't count on it" might be good attention-getters, leading into a basic message explaining the basis for it. The "call to action" is for participants to do their best to adjust their retirement plan deferral rate to put them on track to retire, at a minimum, at a "normal" retirement age, if not a year or two sooner.

As with other participation and deferral increase promotion messages, stress the importance of moving as quickly as possible toward an appropriate deferral rate, even if it cannot be accomplished immediately.

Avoid surprises

If you're successful in moving the needle, the benefits might be as great for you as an employer as they are for plan participants. Be consistent in your communications with employees and an early retirement won't come as a surprise to either your employees or you. ◻



What to do if you inadvertently blow through 415(c) limits

What happens if your plan allocates too much money to a plan participant's 401(k) account in a given year? The IRS recently addressed that issue in its periodic "fixing common plan mistakes" guidance series.

The limit

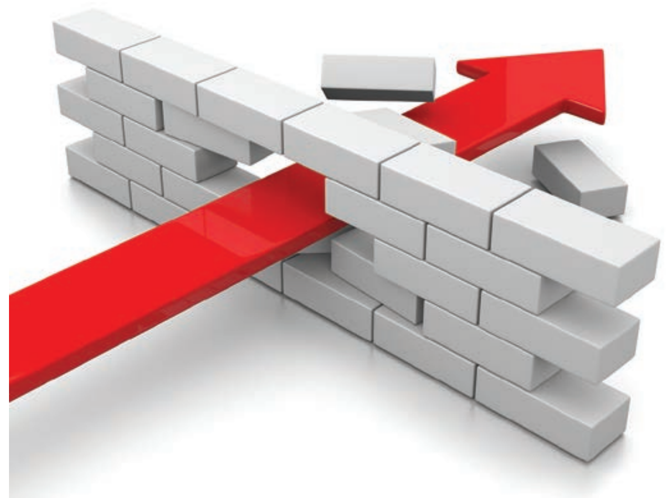
The periodically inflation-adjusted Section 415(c) limit on annual additions to a participant's retirement account covers all five potential contribution sources:

1. Elective employee contributions (whether pretax or Roth),
2. After-tax employee contributions,
3. Employer matching contributions,
4. Employer profit-sharing contributions, and
5. Any other employer contributions.

For 2018, the maximum employee elective deferral amount is $18,500 (or $24,500 for participants aged 50+), and the Sec. 415(c) limit is the lesser of $55,000 or 100% of the participant's compensation. Catch-up contributions aren't counted against the Sec. 415(c) limit. While it's an uncommon scenario to overallocate, you'll need to know what to do if it happens.

An example

An illustration will help. Jill works for a company with a typical 50% matching contribution on the first 6% of compensation. She is a 51-year-old employee earning $150,000. Maximizing her own deferrals to her 401(k) account would have put $24,500 of her own earnings into the plan, plus another $4,500 in employer matching contributions. Because her catch-up contribution of $6,000 is not included for purposes of calculating the total available to comply with the Sec. 415(c) limit, the total available amount for any additional employer contributions is $23,000 before she reaches such limit ($18,500 + $4,500 = $23,000).



But what if Jill also received a $20,000 profit sharing contribution, and another $20,000 employer contribution not linked to profits? That combined $40,000, added to the $23,000, would total $63,000 and put Jill $8,000 over the Sec. 415(c) limit.

The fix

What needs to happen to that $8,000 excess? According to the IRS, you must distribute unmatched contributions to the affected participant. If any excess remains (there wouldn't be, in Jill's case), you then distribute elective contributions that are matched to the participant, and forfeit related matching contributions. If an excess still remains, you must forfeit other profit-sharing contributions.

Once you've dealt with the excess, you report the corrective distribution to the participant on an IRS Form 1099-R. The amount is taxable to the participant, but not subject to a 10% premature withdrawal penalty. Finally, you need to transfer any forfeited employer contributions to an unallocated account that can be tapped to help with your obligations to other 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.

The culture of Insero & Co. is hands-on and proactive, shaped by the old-fashioned notion of doing what is in the best interest of the client. In addition to pension and corporate audits, we provide a full range of tax, accounting and consulting services, including internal audit/Sarbanes-Oxley services, outsourced accounting and wealth management.

Go with the experts

We would welcome the opportunity to discuss your audit or other needs and put our expertise to work for you. Please contact Vince Leo at 585-697-9683 or Mike Giess at 585-697-9639 and let us know how we can be of service.

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