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LiFT Retirement

NEWS AND INFORMATION FOR EMPLOYERS Q3 2019

- AUTOMATIC FEATURES TO HELP BOOST PARTICIPATION AND SAVINGS RATES
- OUR 401(K) INVESTMENTS ARE ON THE WATCHLIST. NOW WHAT?
- LAWSUITS OVER THE YEARS AND WHAT IT MEANS FOR PLAN SPONSORS

Automatic Features to Help Boost Participation and Savings Rates

Two great reasons for small business 401(k) plan sponsors to consider upgrading their current plan design to include auto features: employee participation and savings rates.

#smallbusiness #retirementplan #401k

The use of auto features in 401(k) plans has continued to climb in popularity over the past decade. In fact, auto features such as automatic enrollment and auto escalation are considered best practices in 401(k) plan design as ways to help boost participation and employee savings rates.[1]

Many large 401(k) retirement plans offer auto features. However, small business plan sponsors have been slower to adopt them as part of their 401(k) plan design. If your company's 401(k) plan design doesn't currently include auto features, and/or if you're thinking about implementing them, then keep reading.

SMALL PLANS PLAYING CATCH-UP

The majority of retirement plans (60%) use automatic enrollment. However, there is a noteworthy disparity between the usage of auto enrollment in large versus small 401(k) plans. Two-thirds (66%) of large plans (those with assets of $200 million or more) use automatic enrollment as compared to 51% of smaller plans (those with assets of less than $200 million).[1]

Simply stated, auto enrollment occurs when an employee reaches the plan's edibility requirements and is then automatically enrolled in the company's retirement plan.

Likewise, the uptake of auto escalation — a plan feature that automatically increases participants' contributions each year up to a specified limit — is more prevalent in large than in small plans. Fifty-eight percent of large plans use auto escalation versus just 40% of small plans. Among plans with auto escalation, the majority increase participant deferrals by 1% per year.[1]

When an employee starts saving earlier (auto enrollment) and is regularly nudged to save more (auto escalation), these two plan design features can have a substantial impact on that employee's future retirement savings. Plan sponsors have the power to implement ideas that encourage better retirement savings.

THE IMPACT OF AUTO FEATURES

Automatic enrollment can significantly improve plan participation. According to a recent survey from the Defined Contribution Institutional Investment Association (DCIIA), **before the implementation of automatic enrollment, only 11% of plans had participation rates over 90%. Post-implementation, the percentage of plans with more than 90% participation increased more than fourfold to 46%.[1]** In addition, since automatic enrollment increases plan participation, it also improves the likelihood of a plan passing nondiscrimination testing.

What's more, automatic enrollment improves savings rates, and adding auto escalation further boosts the impact. In plans with neither automatic enrollment or auto escalation, only 44% have savings rates above 10% (includes both employee deferrals and employer matching contributions). In plans that implement automatic enrollment only, the percentage of participants with savings rates above 10% increases to 67%. Where plan sponsors have implemented both automatic enrollment and auto escalation, that percentage rises to 70%![1]

Financial experts recommend that workers save between 10-15% of their pay each year to achieve a comfortable retirement.[2] According to DCIIA, a combination of automatic enrollment and auto escalation is helping more 401(k) plan participants hit that goal, thus increasing their chances of being better prepared for retirement.

GETTING SMALLER EMPLOYERS ON BOARD

Despite the stated positive impacts of auto features on retirement readiness, some employers have chosen not to adopt them for a variety of reasons. One top concern is the fear of employee pushback, including worries that employees will complain.[3]

However, many real case and research studies have found that these concerns are largely unfounded. Opt-out rates for both automatic enrollment and auto escalation are negligible, suggesting that even if employees have initial concerns about the implementation of these plan design features, they generally do not act (i.e., opt out).[4]

There is no one-size-fits-all retirement plan design. However, if your plan goals include boosting participation, increasing employee deferrals, passing nondiscrimination testing, and improving overall retirement readiness, CONTACT US to learn more about automatic enrollment and auto escalation. The implementation of auto features in your company's 401(k) plan may be a solution worth exploring.

1 DCIIA Fourth Biennial Plan Sponsor Survey "Auto Features Continue to Grow in Popularity." December 2017.
2 O'Shea, Arielle. "How Much Should You Save for Retirement?" NerdWallet. August 2017.
3 Goldstein, Justin, AIF. "Adding Automatic Features to your 401(k) Retirement Plan." Bronfman Rothschild. 2017.
4 DCIIA Fourth Biennial Plan Sponsor Survey "Auto Features Continue to Grow in Popularity." December 2017.

Our 401(k) Investments are on the Watchlist. Now What?

What should retirement plan committees do if their plans' 401(k) investments end up on the Watch List? Here are some best practices to manage.

#401kfiduciaires #401kinvestments #watchlist #retirementplancommittee

Approach, review, document, and decide

As a member of your company's retirement plan committee, if you have recently been informed that one or more of your company's retirement plan investments are on the Watch List, **don't panic.** ***This is an opportunity for due diligence and possibly to enhance the plan's performance.***

APPROACH

As a thoughtful plan fiduciary, your company's retirement plan probably had a process in place when you originally selected the investments offered. Whether working with an advisor, hiring an investment fiduciary, and/or leaning on the support of your recordkeeper, some guiding forces probably helped you create the list of investment options. Additionally, you probably have heard the term, Investment Policy Statement (IPS). It is the governing document that helps plan fiduciaries evaluate their investment choices and outline a path of reasonableness for performance. IPS's have a range of methodology criteria; and while IPS's are not technically required by ERISA, they could be the first document that most DOL auditors request when auditing your plan. Therefore, it's a best practice to have one – **and follow it.**

REVIEW

Once your retirement plan's investment methodology is in place (IPS), now it's time to regularly compare your investment offerings against their criteria. This often includes:

- Investment performance against the peer group
- 1, 3, and 5 year rates of return
- Manager tenure
- Expense ratio

To evaluate and aggregate investment information, many plan sponsors ask the help of professional investment advisors. These advisors generally subscribe to screening, monitoring, and score software that catalogs and evaluates over 50,000 investment offerings.

These are just a few of the common comparison criteria. Now that you are objectively evaluating the plan's funds, it's time to review how they are performing compared to your IPS criteria and the peer group. This process provides a reasonable apples-to-apples style comparison. For example, if your plan offers a large cap growth fund, does it make sense to compare that fund against short-term bond funds? Probably not, right?

This would be apples to oranges. Rather, you'd want to line up and compare all funds in the same investment category (Large Cap Growth Funds).

Once you have aggregate data about the funds in the same category, you can review your IPS and start to document your thought process.

DOCUMENT

With the investments evaluated and oftentimes scored based on the peer category and IPS criteria, it's pertinent to start evaluating the results. When a fund is underperforming, it generally means it's time for your retirement plan committee to place that fund on the **Watch List.**

What is a Watch List? Simply stated, it is a list of investment offerings that do not meet the investment criteria outlined in your company's investment policy statement.

Once a fund goes on the Watch List, you guessed it, you should watch it. As the Department of Labor states, *"The primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses."*[1] This includes oversight of the plan investments and a continual obligation to monitor them, so eventually they will provide a retirement benefit to your plan participants and their beneficiaries.

As a best practice after a fund goes on the Watch List, committees should decide how long is reasonably appropriate for that fund to be on watch. This is where documentation is important. Nowhere in ERSIA does it state a defined period of time. Rather, it is up to prudent fiduciaries to determine the horizon – and, of course, to document all thoughts considered.

DECIDE

In the long term, responsible plan fiduciaries will make decisions. They are usually binary decisions that include either:

- Keeping the investment offering within the plan and on the Watch List, or
- Removing the fund in question

Whatever decision is made, it is mission critical to document WHY it was made, HOW it was made (investment reports, history, meeting meetings) and WHAT are the next steps.

In short, if an investment offering is going to stay within the plan and on the Watch List, a prudent fiduciary process is to follow it with documentation.

Also, keep in mind that funds can have periods of underperformance and be placed on the Watch List; then as market cycles change, those funds may meet screening criteria and can be removed and placed back into the good graces of the IPS and screening methodology. In effect, the fund will have regained its status and is no longer on the Watch List.

On the other hand, if the decision is made to replace the fund, a prudent due diligence process should take place to find appropriate fund(s) that meet the IPS and scoring methodology (again, many times this process is supported by an investment advisory professional with access to investment analytics and the vast universe of fund offerings). Once the new fund is selected, it's best to connect with your recordkeeper to understand the replacement process. It usually entails a notice to plan participants and a mapping period.

When a fund is placed on the Watch List, it's not the end of the world. It means that plan fiduciaries need to watch the fund and discuss if the fund's methodology still meets its intended objective. As market cycles ebb and flow, certain investment management styles will come in and out of favor. Investments funds will see periods of meeting criteria and not meeting criteria – ***this may be due to normal market fluctuation.***

What is most important as an ERISA plan fiduciary is to remember to act in the best interest of the plan, your participants, and their beneficiaries at all times. Your documentation of WHY, HOW, and WHAT your actions are should be front and center in your plan's fiduciary process, because the goal of a company- sponsored retirement is to ultimately provide a meaningful retirement benefit to employees.

1 U.S. Department of Labor. "Fiduciary Responsibilities." 18 Apr 2019

Lawsuits Over the Years and What it Means for Plan Sponsors

5 ways plan sponsors can manage their fiduciary liability during the rise of lawsuit trends

#fiduciaryliability #401klawsuits

FORMATION OF LAWSUIT TRENDS

The barrage of excessive fee lawsuits filed in 2006 started a trend that continues to this day. At first, plan sponsors saw early signs of success in getting cases dismissed.

However, this changed after a few years when participants started honing in on claims of self-dealing, i.e. the plan's fiduciaries benefitting themselves at the expense of the plan's participants. Dozens of additional lawsuits have been brought, and plan participants have won both trials and settlements, totaling in the hundreds of millions (over $6.2 billion).[1]

One of the most famous cases alleging self-dealing was *Tussey v. ABB*, which alleged that the plan sponsor caused the 401(k) participants to overpay for services to the plan recordkeeper so that the plan sponsor would receive free or discounted services for other benefit plans to which they were responsible for the cost. Almost ten years later and after a four-week trial and multiple appeals, the case finally settled for tens of millions of dollars.

WHY LAWSUITS ARISE

While plan sponsors accidently self-dealing will happen from time to time, many plan sponsors have heeded the lessons from these lawsuits and have addressed any outstanding issues.

Today, the vast majority of lawsuits allege process violations, meaning the fiduciaries failed to have a good process in place to act in the participants' best interests, and thus the participants were harmed. Allegations include the plan paying excessive recordkeeping fees, failing to monitor the amount of revenue sharing generated, keeping underperforming investments in the plan, and failing to offer an appropriate mix of investment vehicles.

Additionally, the Department of Labor, the federal agency that regulates private retirement plans, has increased its enforcement related to these same issues through a nationwide workforce of plan investigators.

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1 NAPA "ERISA Litigation Tab: $6.2 billion." April 15, 2019.

When an investigation occurs, it can feel and look a lot like a lawsuit, including pages and pages of document requests about the plan.

It is also important to note that unlike class action lawyers, the Department of Labor does not limit their efforts to large plans that results in large damages. The Department of Labor is happy to investigate a plan with only ten participants if they believe harm has occurred. As an example, a recent lawsuit was brought against a small plan sponsor accused of failing to remit employee salary deferrals to the plan, which effectively amounts to theft. The plan sponsor not only faces civil liability, but also criminal liability under federal law.

5 WAYS TO MITIGATE PLAN SPONSOR LIABILITY

Despite the headline grabbing nature of each new lawsuit, there is good news to be found, and that is where a plan sponsor can demonstrate that they have engaged in a prudent process as evidence they are acting in plan participants best interests.

In a recent trial decision in *Wildman v. American Century*, the plan's fiduciaries were cleared of all wrongdoing based heavily on their best practices, which included:

1. Assembling a plan committee made up of diverse individuals with diverse viewpoints
2. Holding a minimum of three meetings per year and special meetings as necessary
3. Hiring a competent, trustworthy plan advisor
4. Providing each new committee member with a fiduciary training manual (consider performing this action during the first committee meeting and recording it in the meeting notes)
5. Regularly reviewing the plan's investments and their performance, including the use of a Watch List

Since most plan sponsors are not experts with regard to retirement plans, many rely on the support of professionals to assist them. A retirement plan advisor can assist plan sponsors with ERISA best practices to mitigate fiduciary risk. For more information on best practices or to discuss your company's retirement plan, contact us to setup a conversation.

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ABOUT US

We provide 401(k) Plan management, education, and wealth management services that provide each individual with a way toward financial success. Our personal approach to the way we work with our clients is rooted in the belief that treating others right and striving for excellence will lead to positive results for all.

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