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Retirement Plan Rx

The latest news regarding retirement plans has centered around service provider fees. While fees are a highly important aspect of managing an vemployer-sponsored retirement plan, they are not the only metric of your overall retirement plan's health. A low-cost retirement plan does not necessarily parallel a fruitful pension program for employees. Studies show that since Social Security was never designed to fully fund an individual's retirement, employer-sponsored retirement plans have become an integral part of employees' overall financial plan for their future. Relying so heavily on this one component should prompt any plan sponsor to ask one very straightforward question… How healthy is my company's retirement program?

Types of Retirement Plans

The U.S. retirement system historically has relied on defined benefit plans commonly called "pensions", as the most common way that companies helped employees prepare for retirement. In pension plans, the responsibilities for funding the plan and investing the plan's assets lay with the employer. Since the late 1980's, employers have migrated to defined contribution plans, with 401(k) plans being the most popular. In contrast to pension plans, 401(k) plan funding is a shared responsibility between the employer and the employee; for most plans, investment decisions are made by the participant. Though this arrangement has been a continuous trend for more than 30 years, experts argue that if employers had a systematic way to calculate the actual cost of employee turnover, they might pay more attention to alternative ways of "paying" employees. If pension plan benefits were factored into compensation packages, an employee might take home a little less pay to have benefits guaranteed in retirement. Consideration of exploring a defined benefit or cash balance plan may be a way to increase overall retirement plan health.

Though many small employers favor the 401(k) plan approach, not all plans are created equal. All 401(k) plans allow for employer contributions, but, unless the employer elects a Safe Harbor option, these contributions are discretionary in both the amount and allocation method. Therefore, the benefits of any 401(k) plan can vary drastically depending on the annual funding decisions of the plan sponsor. By educating employees on plan options, the benefits of saving more, keeping deferral rates up, and utilizing all financial resources, it is possible to optimize any company budget to ensure everyone on the team is saving more for retirement.

A 2014 study of 9 million U.S. employees' data revealed that less than 50% of workers ages 20 to 29 are currently saving for retirement. Of that group, the average contribution rate was less than 5%! The numbers increase with older participants but, even in the 50 to 60 age group, only 65% of employees were participating in their company's plan, with an average contribution rate of 7.7%. Numbers approaching 70% are healthy figures and above that, even better still. If a plan's participation is in the 40-60% range, there are likely a few ways to boost participation numbers, as well as participation contribution rate.

Getting Employees to Join the Plan

Education: As employers started to replace pension plans with defined contribution plans, retirement education became, and remains, incredibly important. Lack of employee education is the most common reason cited for not participating, or participating further, in a company's retirement plan, especially amongst lower income workers. There are many reasons employees don't follow through on enrollment in a retirement plan but it largely seems due to complicated processes. There are myriad decisions to make and confusing paperwork to complete. Industry jargon, along with a large menu of investment options, can be intimidating or confusing. The best way to encourage participation is to keep the plan straight forward, accessible, and provide access to great educational tools. Try to avoid overwhelming people with excessive paperwork or educational schedules that don't match their work environment. There is a wealth of materials available for employees, such as articles, videos, and online tools like webinars, that can be posted to a web portal or made accessible through Human Resources.

While providing educational materials via the use of technology is beneficial, especially for the younger generation, there is still no replacement for personal interaction with the people who handle your retirement account. Group seminars to discuss plan features like fees, cover performance information, and discuss how integration of your retirement assets should work in conjunction with Social Security benefits are excellent ways to breakdown participation barriers. Most financial advisors are more than willing to help in this endeavor. The most successful tool of all may be one-on-one meetings between the plan's investment professional and the participant.

Age Group	% of Employees Who Saved	Savings Rate
20-29	48.4%	4.9%
30-39	57.9%	5.7%
40-49	62.4%	6.3%
50-60	65.6%	7.7%
61-69	64.4%	9.2%
TOTAL	60.2%	6.7%

"The Retirement Savings Paradigm: Factors Influencing Saving" by the ADP Research Institute.

Automatic Enrollment: It may be easy to provide education to those employees that are in the office and are working standard daytime hours; but, when workers are remote, in-field, or second and third shift, the availability of thorough education is strained.

To combat low participation rates, some employers are adopting automatic enrollment of employees into a 401(k) plan. Automatic enrollment allows an employer to enroll an employee into the company's plan at a determined contribution percentage unless the employee makes an election not to contribute, or an election to contribute a different amount. Employees who are intimidated by the decisions of enrolling in the plan and fail to complete the appropriate enrollment paperwork will default into participating as opposed to defaulting out. It is important to understand that this does not make participation mandatory because employees can make an affirmative election to opt out at any time. Especially valuable for those with workers in the field, remote workers, and later-shift employees, automatic enrollment has proven to be an excellent participation enhancement tool.

Roth 401(k) Option: The Roth 401(k) combines some of the most advantageous aspects of both 401(k) plans and the Roth IRA. Under the Roth 401(k), employees may contribute funds on a post-tax elective deferral basis, in addition to, or in place of, pre-tax elective deferrals under their traditional 401(k) plans. This option is especially attractive to younger workers which are residing in a lower tax bracket now, but probably won't be in that same bracket at retirement age. While the Roth 401(k) option will require additional administrative record keeping, it provides another way for participants to become involved in their financial future.

Mobile Options: As highlighted in our April issue, "Benefit Communications in an Electronic World", keeping up with technology can go a long way in attracting younger workers to participate. As smartphones and tablets have become engrained in both work and personal life, it makes sense to include your retirement and investment information on a platform which is readily available and more likely to be accessed. For those with a higher percentage

Rise of the Machines

Over the last 30 years, there's been an incredible array of advancements in technology that have impacted various parts of our lives. While not all of them were amazing, many of them inherently improved our quality of life and some allowed us to catapult forward into a world of instantly accessible information on a scale never witnessed. As computer science has seeped into almost every facet of life, there's been an increase in connectivity, productivity, and efficiency.

The world of investments is no exception. Enter the latest Cyberdyne-esque creation to go mainstream… the Robo-Advisor. While it is not likely that any big budget action movies will be released out of Hollywood on its behalf, its impact on the way people invest their money may prove to be explosive nonetheless.

Robo-advisors are a class of auto-adviser that provide financial advice or portfolio management online with minimal human intervention. These systems provide digital financial advice based on mathematical rules or algorithms. The algorithms are executed by software automatically allocating, managing, and optimizing clients' assets and thus provides financial advice that does not require a human advisor. The rise of the machines emerged in 2008, most prominently in the States, and today there are over 100 of these services offered to plan sponsors and investment advisors.

Is this something to be truly considered? Could it help participants with their investment decisions? While we know that nothing can replace the knowledge and comfort that participants can get from meeting with a financial advisor, some advisors are considering adding robo-services as a companion option to their financial advice with an aim to further engage participants in the plan and perhaps as a tool for those hard-to-reach workers (remote or field workers, and those that work late night shifts).

While robo-advisors may not be the solution to a universal education on retirement plans, they add an intriguing new option for advisors and sponsors to explore and thereby enhance the engagement of their participants. While the automation of such a cumbersome task is exciting, navigating the investment selections in a retirement plan is not perfected by algorithms. Some of the most important financial decisions require real-life advice from a real-life person, the financial advisor.

of millennials in the employment ranks, this is becoming more of a necessity than just an innovative idea. Providing low-cost apps allows workers to take care of benefits on the devices that they are already familiar with and constantly using.

Increase Deferral Rates: Once employee participation rates are higher, it is time to encourage team members to save more. Debunking some of the misconceptions that participants have regarding their plan through good educational tools will go a long way, but there are a few other avenues to consider as well.

Increasing Automatically Enrolled Contributions: Automatic enrollment, as mentioned before, is a highly-effective way to increase participation rates. While plans offering automatic enrollment garner more participation, the typical 3% default contribution is usually not touched after the initial enrollment. Increasing the rate of the default contribution will bolster a participant's account balance and the plan's assets, furthering their chances of a healthy retirement. A slight increase to the contribution level of just 1% or 2%, goes a long way towards improving their retirement outlook.

Stretching a Match: One of the most prevalent misconceptions that participants have about their 401k plan is that the maximum they can contribute is equal to the cap that is placed upon the matching contribution made by the employer. For example, if an employer contributes a match of 25% up to 4%, participants tend to elect 4%. To persuade participants to increase contributions, some plan sponsors have adopted a stretched match as a form of motivation. There are a variety of matching formulas that incentivize increased deferrals and are often cost neutral to the employer. An example might be as follows:

- 100% on the dollar up to 3% of pay most likely results in a 3% contribution from the participant for a total contribution of 6% of pay.
- 50% on the dollar up to 6% of pay (still a 3% outlay for the employer) encourages a 6% contribution from the employee and a combined contribution total of 9%.

If offered, participants often try and maximize the benefit and push deferral rates to take full advantage of the cap on matching contributions. If the employer sponsors a Safe Harbor plan, there are still options available to "stretch" the match.

Automatic Escalation: Many companies are now implementing auto-escalation in their 401(k) plans. With auto-escalation, the contribution level is automatically increased at regular intervals, typically 1% a year, until it reaches a preset maximum. Plan sponsors are free to choose the maximum automatic escalation contribution percentage that works the best for their plan. The goals of the plan should always be considered in conjunction with a percentage increase that will not compromise an employee's income needs. Given that many employees rarely change their level of contribution once enrolled in the plan, auto-escalation is an excellent way to help employees save more for retirement.

Utilizing Your Resources

How often is the company in contact with the advisors for the plan? How often do employees have a chance to attend meetings and ask questions? Do they have access to that resource outside of scheduled group meetings?
Interaction with knowledgeable plan advisors is a facet of retirement education that is underutilized. Ideally, participants should attend an educational meeting at least once per year. If the employer or participant's plan goals have changed, the respective pension professionals are there to help the company adapt. Additionally, the investment selections currently offered in the plan may become less desirable over time and necessitate a recommendation for replacement and presentation to the participants of the plan. Showing the employees that the plan sponsor is actively engaged in keeping the plan up to date through the knowledge of their advisors is an effective way to sustain ongoing interest in the plan.

Future Possibilities…?: The future may hold further developments directed squarely at retirement health. Auto portability has presented itself as a possible solution to the massive premature withdrawal of retirement funds. Auto portability is the routine, standardized, and automated movement of an inactive participant's retirement account from a former employer's retirement plan to their active account in a new employer's plan. It serves the needs of participants that are subject to the mandatory distribution provision of their plan (account balances less than $5,000) to curb the levels of cash-out leakage occurring as participants change jobs. Auto portability could be adapted to larger account balances should a higher mandatory distribution limit be dictated by policy. Both fast and slow cash leakage could be greatly reduced through these practices and help reduce the overwhelming cash-out epidemic that currently adversely affects your retirement plan health and the health of its participants. Why the hold up? Retirement Clearinghouse, the company leading the charge, is seeking the Department of Labor's okay to use negative consent for auto-portability, clearing up the chance of any unintended consequences for plan sponsors and recordkeepers. Auto portability just may be a pension innovation worth keeping an eye on.

In Conclusion

A healthy retirement plan is a valuable benefit for the future lives of all involved, especially as younger generations may face a changing Social Security program. With a little bit of attention and education, employers and employees alike should be getting the most out of their participation in the plan. In order to optimize a sponsored plan, it's crucial to educate everyone involved, keep deferral rates up, and utilize all the financial advice resources available.

Participant Loans: Benefit or Detriment?

For many years, plan sponsors have wrestled with the decision to offer loans to their plan participants. Some consider them to be a benefit and even promote them as a legal way to use tax free money while participating in the plan. According to the Employee Benefit Research Institute, 87% of plan participants can take a loan against their retirement account. Of those employees with access to take a loan, about one-fifth borrow against the retirement account. Come retirement, what are the effects of loans taken from pension funds on an employee's account?
A few years ago, the term "Account Leakage" started to be used when reporting on the effects of participant loans. Account leakage refers to lost asset accumulation due to reduced earnings, elections to reduce contribution levels, and the cashing out of account balances when participants terminate.

Lost Accumulation Due to Reduced Earnings: When a participant takes a loan, the interest rate, which is detailed in the plan's loan agreement, must be "reasonable" and is commonly tied to the prime rate plus 1% or 2%. Recently, the prime rate climbed to 4%. Most participant loans in existence have rates based upon 3.5%, the prime rate in effect for the last several years. With the value of the loan earning a rate of 4.5% to 5.5%, participants with loans could well underperform the returns of the investment options offered within their plan. Since the duration of most loans is 5 years, there can be significant loss of earnings that will ultimately erode their account balance at retirement.

Elections to Reduce Contribution Levels: Under the terms of a participant loan, the participant must agree to make loan payments no less frequently than on a quarterly basis. To simplify collection procedures, most employers require that loans be paid through payroll deduction which consequently reduces take-home pay. Many participants elect to reduce, or even eliminate, their contributions to the plan to alleviate the impact of the loan payment on their paycheck. Given that the most common term for a participant loan is five years, employees are losing those contributions, and the earnings on those contributions, towards their retirement.

Cash-out of Account Balances: When a participant terminates employment, they must decide what to do with their account balance from their former employer. Studies show that nearly 40% of terminated employees ask for a cash distribution and, according to Morningstar, in 2013 that added up to about $68 billion that leaked from retirement savings. When a participant loan is part of the account balance, participants are faced with an even more demanding situation. Since the majority of plans require payment of the outstanding loan balance at termination, the former employee must have the cash to repay the loan in full. As a result, over 70% of plan loans default and become a taxable distribution.

Account leakage is a significant issue in retirement planning with some experts even calling it a crisis. What is a plan sponsor to do? Some companies are offering low-cost loan alternatives to discourage employees from borrowing against the plan; leaving account balances intact. Other sponsors offer services with a financial advisor who can encourage other financial options or compare the loan program with other low-cost lending. Limiting loan availability to one at a time, encouraging early payoffs, and instituting a waiting period between the initial loan payoff and the start of the next, has helped to minimize the prevalence of a negative loan impact on the plan. Reducing the number of loans has helped many sponsors to keep participant account balances intact and to reduce the administrative burden of maintaining them.

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