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Participant and Sponsor Challenges

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Unfortunately, only 51.8% of all employees in the U.S. are covered by any type of employer-sponsored retirement plan.[1] What does this suggest? It tells me that 48.2% of U.S. employees either have no plan or are relying on IRAs at a time when the state of Social Security is vulnerable and age longevity is increasing. It portends a senior demographic facing increasing difficulty in making ends meet.

As mentioned in previous articles in this series, employers increasingly favor the 401(k) model when choosing a retirement plan to provide for their employees. Employers are also more keenly aware that the choices they make regarding those plans can be instrumental in affecting their employees' retirement readiness. Some of the challenges plan sponsors (aka employers) face include enhancing employee participation, along with ever increasing fiduciary responsibilities and compliance-related issues. Fiduciary responsibilities and compliance-related issues are a consideration in all aspects of managing a qualified retirement plan.

Enhancing Employee Participation

Believe it or not, one of the biggest hurdles that employers have is encouraging employees to save by participating in the plan! Some employees feel they cannot afford to participate because of other financial demands. (Perhaps it is because we are a consumer-driven society, and some are not in the habit of saving.) Others may simply be intimidated by the plan itself.

Over the years, employers have encouraged participation in many ways, including hosting enrollment sessions to better educate employees, along with sponsoring various enrollment incentives. With the passage of the Pension Protection Act in 2006, plan sponsors had an Automatic Enrollment option they could adopt to automatically bring employees into the plan.

[1] *National Institute on Retirement Security, The Retirement Savings Crisis, June 2013*

The study of behavioral finance tells us that people often suffer from inertia where financial decisions are concerned. With that in mind, if an employee has to actively enroll in a retirement plan, there is a good chance they won't. The same principle applies if an employee is automatically enrolled in a retirement plan at a predetermined contribution rate; it is unlikely they will opt out.

In any case, it is doubtful that a participant will be able to retire on the original rate of contribution chosen. In fact, many participants have no idea how much money they will need at retirement. It takes a little work, but there are various websites that can calculate an estimate for one's particular circumstances. (Some plan websites include links to these tools.) Such tools can prove invaluable, providing the participant a tangible goal.

The plan sponsor has several additional tools to encourage employee participation, the first of which is plan design. Some of the plan features that can entice employees to participate in a plan are:

- Providing a match to a higher rate of contribution, thereby encouraging participants to save more in order to qualify for the full benefit of the match.
- Incorporating a profit sharing feature.
- In addition to automatic enrollment, plan sponsors can now offer automatic escalation. By adopting this feature, participants will have the percentage of their contribution increased, usually on an annual basis, by a set amount.

Beyond plan design, the plan sponsor can encourage plan participation through the thoughtful selection of investment options that are made available to the participants. Because there are so many options to consider (mutual funds, Exchanged Traded Funds (ETFs), collective trusts, etc.), the plan sponsor must carry out due diligence, many times with the help of an adviser who specializes in qualified plans. Additionally, plan sponsors can offer educational services of good investment practices, either through its plan website or by making financial advisers available to the participants.

If a participant does not want to actively make investment decisions, the plan may offer a menu of target date funds; i.e. actively managed funds that adjust a portfolio over time according to a fixed retirement date. Beware: Target date funds are not alike; research is required. Remember, retirement funds need to last throughout one's entire retirement, often for many years.

An employer-sponsored retirement plan is also beneficial to the employer. The employer and other "highly compensated employees"[2] (HCEs) are more likely to contribute to the plan at a higher rate than non-highly compensated employees. The Employment Retirement Income Security Act of 1974 (ERISA) states that unless a plan satisfies one of several safe harbors, the plan must be nondiscriminatory in providing benefits. Each year, retirement plans must undergo testing to verify that HCEs did not benefit more than non-highly compensated employees. If the plan does not pass the test, contributions must be returned to the HCEs to bring the plan into compliance. As a result, HCEs are unable to declare as large of a deduction on their tax returns. Qualified plans with a high rate of employee participation are less likely to fail their testing.

In sum, employers with a well-administered retirement plan have an important tool to attract and retain knowledgeable employees—and those employees have an easy way to save for retirement! Further, all employees have the opportunity to contribute at higher rates as participation increases.

Increasing Fiduciary Responsibilities

Plan sponsors are the fiduciaries of the retirement plans. According to Investopedia, a fiduciary is "one who has been legally appointed and authorized to hold assets in trust for another person. The fiduciary manages the assets for the benefit of the other person rather than for his or her own profit."

Often times, fiduciary duties are outsourced to an adviser who specializes in qualified plans. Legally, however, the plan sponsor is ultimately responsible for the plan.

A fiduciary is expected to base decisions on the "prudent man rule." The rule states that "fiduciaries must act as a prudent man or woman would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments." As such, the fiduciary decision-making process involves the following steps:

1. Organize and analyze the information available;
2. Formalize the expectations;
3. Implement the decision or practice; and
4. Monitor the process and exercise due diligence.

[2] *Highly Compensated Employees (HCEs) are defined by the IRS for 2013 as either 5% owners or those with compensation equal to or greater than $115,000.*

In the retirement industry, this process has been expanded to include the hiring of advisers, record keepers, and vendors.

Increasing Compliance-Related Responsibilities

As discussed in previous articles in this series, retirement plans are dynamic entities, affected by ongoing legislation and overseen by both the Department of Labor and the Internal Revenue Service. By all means, it is a challenge for plan sponsors to monitor their plans to ensure they are compliant with an ever-changing set of rules.

Currently, the major compliance issue affecting qualified retirement plans is the Department of Labor 408(b)(2) regulation, ensuring that pension plan fiduciaries have sufficient information to determine the reasonableness of compensation and fees paid to service providers and to evaluate potential conflicts of interest that may affect the performance of those service providers. All fees or compensation paid by the retirement plan must be reported annually on the plan's IRS Form 5500.

Ultimately, all of the compliance-related responsibilities are an effort for the plan sponsors to provide successful, fair, and well-documented means for people to save for retirement. It becomes a moot point, however, if the employee does not take advantage of the benefit which has been offered to him/her!

The "FRIDAY FOCUS" on Retirement series includes:

'**Memorandum #105:** *History of Pensions*

'**Memorandum #106:** *Pension Plans—Types and Characteristics*

'**Memorandum #107:** *A Primer on IRAs*

'**Memorandum #108:** *Participant and Sponsor Challenges*

'**Memorandum #109:** *Planning for a Successful Retirement*

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