Retirement Report

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In This Issue:

Fees

Chances are that sometime recently an ad for a product or service you had some interest in grabbed your attention. Whatever it was, it intrigued you enough to do some research and find out if it really was a good deal. After further investigation, maybe you realized the product or service wasn't as good as you first thought. Others were offering the same product for less, or including more bells and whistles for the same price. Trying to figure out which deal is best can be confusing because no two offers are exactly the same. Furthermore, if it's something you don't need at the moment, you may find it easier to deal with later.

As a plan sponsor, you've likely gone through a very similar experience. With the 408(b)-2 regulations in effect, you've now received information from your providers that shows how much it costs to use their services, and it would be safe to assume that they promised you're getting a great deal. At the same time, their competitors are probably pounding on your door with what they believe are better offers. Sounds interesting, but you're not really in the market for a new

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provider and there are lots of other things on your plate that are more pressing, so you figure you can set it aside and deal with it later.

The problem is that this may not be a good enough answer for the Department of Labor (DOL). As a plan fiduciary, one of your key responsibilities is to ensure plan fees are reasonable, especially when the plan and/or its participants are absorbing the cost (which is the case for the vast majority of fees in a defined contribution plan). And with this new information in your hands, the expectations of the DOL are that you will be in a position to do so. But how do you prove the fees for your plan are reasonable?

The only true way to do this is to take your plan to the market and find out what other providers would charge. An important first step in creating a level playing field is to find out exactly what services your current provider is delivering. Once you have this, package it along with demographic information about your plan (number of participants, how your plan's assets are allocated among the funds, cash flow, etc.) in the form of a request for information (RFI), distribute it to a group of three to five providers you believe would be able to service your plan and have them tell you what revenue they would require to deliver the same suite of services to your plan. Your trusted advisor can shoulder most of this load for you.

Having the results in hand puts you in a much better position to determine if your plan's fees are reasonable. If they are, you've satisfied your obligation as a plan fiduciary and done what the DOL is expecting. If not, look for opportunities to bring them in line with the market. This could include lowering or eliminating any out-of-pocket costs, lowering investment-related fees and/or possibly adding services.

In any event, it's important to recognize that this is not something you can put aside for a later date. The sooner you go through this exercise, the sooner your participants will likely benefit from your being a prudent fiduciary who is carrying their responsibility to ensure plan fees are reasonable.

Not only is it your responsibility, it's good business, so do it prudently and make sure you document what you've done.

— Mike Falcone, Director of the Eastern Region

Investment Commentary: Specialty Funds and Retirement Plan Implications

Specialty funds generally refer to funds that invest in focused or relatively small market segments in the global marketplace. Some of the more common include emerging markets funds, science and technology funds and real estate investment trust (REIT) funds. While specialty funds can add value to a portfolio when used properly in an investor's overall asset allocation, they can also be extremely risky and deteriorate the value of a portfolio if used improperly. This can occur when utilizing specialty funds as a substantial part of a portfolio, or even diversifying across a number of specialty funds, which can lead to a false sense of security.

Emerging markets, a strong performing sector as of late, provides one example of the downside risk faced by investors. The MSCI Emerging Markets index provides evidence that the risk of a large loss is possible in a very short time. The worst one-month return since its inception was -29 percent, which was almost twice that of the worst monthly return for the S&P 500 index (-14 percent) across the same time period (October 1989 through March 2013). Science and technology fund investors witnessed this same volatility years ago during the dot-com bust (2000–2002). According to Morningstar's Technology fund universe, if an investor bought into technology at its high point and sold at the bottom, that investor would have lost 82 percent, a devastating impact to any individual's retirement plan.

Not only do specialty funds provide participants with volatile investment options that can hinder them in attaining their retirement goals, but the fiduciary is charged with an additional responsibility to educate participants on how these investments work and how they should be used. This can be a complicated task due to the unique nature of specialty funds, but is a very necessary one considering that participants are generally unaware of the associated risks. Only after understanding all of the issues associated with specialty funds can the fiduciaries make the best determination of their suitability in the plan.

DOMA Ruling Raises Big Questions for Plan Sponsors

The U.S. Supreme Court's ruling that overturned a key section of the federal Defense of Marriage Act (DOMA) holds wide-ranging implications for retirement plans and participants. Among other things, it affects how account assets are divided in a divorce, how they are distributed in retirement and how they will be parceled out upon an account holder's death. Beyond retirement plans, the decision has major ramifications for health and welfare benefits and for income and payroll tax rules.

On June 26, the court struck down the section of the 1996 measure that, for purposes of federal law, said the term "marriage" must be limited to marriage between a man and a woman and that the term "spouse" must be limited to

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opposite-sex spouses. Now that this portion of the law is moot, implementing the court's decision for retirement plans will depend largely on how the Obama administration and various federal agencies interpret the decision as well as existing federal law and regulations. The exact contours of what will follow remain uncertain.

"We are very early in the process," said Jamey Delaplane, head of Vanguard ERISA and Fiduciary Services. "There's a lot we don't know yet."

In principle, the ruling in *United States v. Windsor* means that:

- Same-sex spouses who live in a state that recognizes their marriage will now have spousal consent rights currently limited to opposite-sex spouses, such as default beneficiary rights, qualified joint and survivor annuity benefits and qualified preretirement survivor annuity benefits. They also will be able to request a qualified domestic relations order to protect their retirement benefits in the event of divorce.
- Same-sex spouses qualify for the more favorable required minimum distribution and rollover rules for retirement plans and individual retirement accounts that apply to spouses, rather than those for non-spouse beneficiaries.
- The IRS safe harbor for hardship distributions from a 401(k) plan apply to same-sex spouses, thus allowing qualifying distributions to pay for medical care, tuition and burial costs.

While that much seems clear, Delaplane said key points about execution are unresolved.

Plan sponsors don't yet know how a plan's spousal benefits will be affected if same-sex couples who live in one of the 37 states that do not recognize same-sex marriage were married earlier or get married in the future in a state (or country) that does recognize same-sex marriage. For example, work transfers for same-sex couples may involve moving from a state that recognizes same-sex marriage to one that does not; how plans should treat such participants and situations is not yet clear.

ERISA historically required a uniform federal process for administering benefit plans and generally preempts state law. However, since ERISA does not define the term "spouse," it will likely be necessary to look to the state law definition of marriage. Variation among states' laws regarding same-sex marriage creates significant complexity. Benefit plans may well have to use differing rules when their participants and participants' beneficiaries live or work in multiple states.

"Plan sponsors will need to evaluate their plan documents and plan operations to implement the Windsor decision," Delaplane said. "They may need to amend the definition of spouse in their plan documents. They also may need to begin tracking the states in which same-sex couples live or marry, depending on the guidance the federal government provides."

This article was originally published in Vanguard's July *Your Insights* newsletter.

Employee Communication Strategies for All Seasons

With all the uncertainty in the marketplace, there is no better time to provide education to your participants than today! Education may include the following channels: employee meetings, webinars, memos, flyers, payroll stuffers or mailers, just to name a few. We encourage you to utilize a variety of these methods to keep the material fresh and exciting to participants. We also encourage you to focus on more than one education topic throughout the year. For example, during one quarter, you may consider mailing participants a piece on the benefits of automatic rebalancing. The next quarter, your education focus could be on investing during recessions. The following quarter could be a webinar to tour your service provider's website capabilities. We also encourage you to reach out to your service provider to see what new information and materials they have available for your participants and find out what assistance they may provide. Creating a clear education plan is a great way to keep you on track to meet your goals and objectives.

Communication Corner: Most Popular Investment Option

This month's sample employee memo is part two of our six-part series in which we answer common participant questions. In part two, we answer the question "What is the most popular investment option in retirement plans?"

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase (fiduciarybriefcase.com), which is also available in Spanish.

Call or email your plan consultant if you have questions or need assistance.

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We’re Listening to You!

We are pleased to present the second installment of our six-part series, answering the most common questions we receive from you, our participants, on the path to becoming retirement ready.

We are committed to helping you retire on time and to keeping you informed. The more questions you ask and the more active you are in your retirement plan, the more we can focus on what is important to you. Let’s keep this communication going!

Question:

What is the most popular investment option in retirement plans?

Answer:

For the past few years, the most popular investment option for participant contributions has been and continues to be an asset allocation fund. Your plan probably offers one of two types: a target-date fund (TDF) or a lifestyle fund (LSF).

TDFs and LSFs have become very popular because they offer an attractive, single-choice solution that is appropriate for most participants. They are known as the “do-it-for-me” option because of their management by a professional who designs a diversified portfolio of mutual funds appropriate for participants who retire around a specific year (with TDFs) or pursuant to a particular risk level (with LSFs).

Target-date Funds
TDFs are designed to become more conservative as you approach your retirement date. The date is found in the name of the fund and is the basis for your selection. You simply select the TDF that contains the year nearest to your anticipated retirement date (i.e., Target Date 2030, 2035, 2040, etc.). The target date is the approximate date when investors plan to start withdrawing their money. (Note that the principal value of the fund(s) is not guaranteed at any time, including at the target date, and if the funds’ objectives change over time, the objectives and investment strategies will also change.) As the target retirement date approaches (and often continuing after the target date), the fund’s asset allocation shifts to include a higher proportion of more conservative investments, like bonds and cash instruments, which generally are less volatile and carry less investment risk than stocks.

Lifestyle Funds
LSFs are designed to suit your investment risk comfort level. They are selected as a match with your risk level as an investor: conservative, moderate or aggressive. The idea is to retain this fund as long as your risk level remains the same. If you have an event that causes you to reevaluate your risk level (i.e., you are closer to retirement or you win the lottery), you should transfer your account balance to the fund mirroring your current risk level.

Unless you are truly comfortable constructing and managing your own portfolio of investments, TDFs or LSFs may be very helpful to you.

If you have any questions, speak to the plan administrator.

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