SAPERS & WALLACK

Retirement Report

Volume 12, No. 1

In This Issue:

Retirement Income Solutions with Guaranteed Minimum Withdrawal Benefits (GMWB)

Retirement income solutions (RIS) are retirement plan investment options designed to generate a post-retirement income stream from participant-accumulated retirement savings, and include guarantees of minimum withdrawal amounts for life. These products, generically known as guaranteed minimum withdrawal benefit (GMWB) programs, intend to address the very real issue of retirees exhausting their savings during their lifetime. These products incorporate benefits of equity investing (i.e., target-date funds) with annuity income features and minimum withdrawal guarantees for an added fee (presently 50–100 basis points depending on guarantee provisions).

continues >

RIS/GMWBs are currently experiencing dynamic product development and are attracting significant interest in the press and among plan sponsors.

As these products continue to evolve and become more accessible, this concept is also receiving support from Washington regulators who are concerned about the issue of retirement readiness of the population in general. Phyllis Borzi, assistant secretary of the Employee Benefits Security Administration (the enforcement arm of the Department of Labor [DOL]), is stimulating a national dialogue on the topic of participant retirement readiness and potential solutions to the well-documented problem that few participants are on track for successful retirement. Interested parties are predicting that these products may receive similar support as auto enrollment received from the Pension Protection Act of 2006.

Interest in GMWBs at the plan level does denote certain fiduciary implications. Offering a GMWB as a core plan investment option is a fiduciary decision and carries the responsibilities that any fiduciary decision entails.

How should a fiduciary prudently consider these products?

First, utilize the same process in making all investment fiduciary decisions. Recent DOL guidance on selecting and monitoring qualified default investment alternatives (QDIAs) may be applicable to RIS and GMWBs. This process includes what the Internal Revenue Service considers “procedural prudence,” and consists of the following steps:

- Identify and gather information to be considered.
- Evaluate the information as a prudent expert (hire an expert if necessary).
- Determine the most prudent course of action to benefit participants.
- Take appropriate action.
- Document activity.
- Periodically revisit the decision to ensure that it continues to be prudent.

Second, evaluate factors unique to GMWBs and RIS products:

- **Guarantees** – The existence and viability of guarantees make these products attractive. Considerations include: What are the guarantees? What is the financial strength of the provider supporting these guarantees (evaluate capital/surplus/reserve adequacy)? What is the experience and expertise of the insurer with this or similar products? Is the cost/benefit analysis of the product “reasonable” per DOL standards? Would this product produce a significant benefit for participants?
- **Hedging** – A significant component in RIS products, how is the hedging accomplished? What is the history and strength of their services?
- **Administrative capabilities** – What is the provider’s experience administering RIS? What is the history and strength of their services?
- **Portability** – What accommodations are available to participants in the event of fund or provider removal? Or upon eligibility for distribution?
- Are there alternative solutions available? Might this issue be better addressed with an “out of plan” solution, thereby avoiding the fiduciary issues?

Every provider’s version of RIS/GMWB is different. Each has unique provisions that need evaluation, such as the nature of guarantees of income, participant access to their account balance, annuity purchase rates, etc.

It is anticipated that RIS or similar products will play a meaningful role in participant retirement planning in the near future. It is still early in the stage of product development, and there is not yet any direct guidance or safe harbor provision from the DOL for fiduciaries. These products are likely to evolve considerably over the next few years. The interest rate environment may become more conducive to providing attractive annuity purchase rates. Based on regulator support, there soon may be fiduciary safe harbor for fiduciaries. As these products evolve and conditions change, some of the above questions will be easier for a fiduciary to answer.

continues >

The development of products that can serve the participant in a meaningful way is to be applauded. Your plan consultant would be happy to assist if you decide that RIS/GMWB is timely to consider for your plan.

— Michael Viljak, Senior Plan Consultant

Specialty Asset Classes in a Retirement Plan Menu

Specialty asset classes are those which do not fall into the "core" group of asset classes. Core asset classes include: U.S. domestic equities, international and fixed income. For the purpose of this commentary, specialty asset classes consist of the following: technology, health care, emerging markets and real estate.

While specialty asset classes can provide value when constructing a fully diversified portfolio, their inclusion in a retirement plan as a stand-alone option is potentially problematic. The concern revolves around expanded fiduciary liability exposure created by potential unsophisticated participants utilizing specialty asset class investments inappropriately.

The classic scenario is where a participant nearing retirement learns of attractive returns a co-worker has obtained by investing in a specialty asset class (e.g., technology in the late 1990s). Subsequently, the participant decides to invest a significant portion of his/her account balance in the same specialty fund in an attempt to achieve similar returns. Due to volatility inherent in this asset class, the investment experiences a significant loss over the next year, and the participant becomes disgruntled and seeks reparation from the plan. The participant may contend that he/she did not receive appropriate education regarding the risks inherent in the investment. And fiduciaries may be liable for allowing an imprudent investment to be offered within their plan.

Note that many core asset class funds do have some exposure to specialty asset classes. International funds may have some emerging markets exposure. Core bond funds may have high yield exposure. Domestic equities may have health care, technology and real estate exposure. This may cause some participants who invest further in specific specialty funds to be unknowingly and inappropriately over-weighted in specialty asset classes.

Other concerning issues also exist. In the event of underperformance of a fund (or provider), where fund removal and mapping becomes appropriate, some providers do not have multiple options within a specific specialty class. To where, then, should these assets be mapped? There is no clear "fiduciary-safe" answer. In addition, many specialty asset classes do not yet have substantial benchmarks to assist in monitoring, a fiduciary responsibility.

The inclusion of specialty asset classes in a retirement plan menu should be considered carefully, and subsequently the decision for or against should be well-documented in the retirement committee's meeting minutes. Your plan consultant is happy to help you with this process.

Understanding Fee Methods

The following is an excerpt of "A Closer Look at Fee Structures: What you may not know about fulfilling your fiduciary duty." Principal Financial Group. *Thought Capital – Understanding Fee Methods.* September 2013.

A plan fiduciary can elect to pay or allocate plan fees in a number of different ways. In fact, the DOL observed in Field Assistance Bulletin (FAB) 2003-03 that plan sponsors and fiduciaries have considerable discretion in determining, as a matter of plan design or a matter of plan administration, how plan expenses will be allocated among participants and beneficiaries.[1]

The plan fiduciary should consider how plan fees are charged. According to the DOL in FAB 2003-03, "Where fees or charges to the plan are determined on the basis of account balances, such as investment management fees, a per capita method of allocating such expenses among all participants would appear arbitrary."

For example, if the recordkeeping fee is 25 basis points of assets, that arguably supports a pro-rata allocation of the fee. On the other hand, if the record keeper charges $100 per participant, that may support a per-capita allocation.

All retirement plans incur various fees for the ongoing operation of the plan. Typically, plan fees are allocated or collected through one or a combination of fee payment methods. What follows are brief summaries of these methods.

continues >

Billed Fees
A plan sponsor may elect to have all or a portion of the plan's fees billed. This bill would typically be paid by the plan sponsor. Fees are not allocated among participants and beneficiaries nor are plan assets used to pay these fees. The billed fees are typically included in the plan sponsor's annual budget for planned expense obligations.

Deducted Fees
A plan sponsor also has the option of electing to have all or a portion of the plan fees deducted from plan assets. In the case of a defined contribution plan, these fees reduce the amount of retirement savings in participant accounts either in proportion to their account balance (pro rata) or as a flat dollar amount.

Asset-Based Fees
A plan fiduciary may choose to have all or a portion of the plan's fees collected as an asset-based fee. This amount is typically expressed as a basis point[2] and is generally collected monthly (though some service providers may collect this quarterly) from participant accounts.

Revenue Shared with Service Provider
The term "revenue sharing" is frequently used to refer to payments that are made by an investment option[3] such as a mutual fund, or its investment manager or affiliates, to a service provider for employer-sponsored retirement plans for work in keeping track of the ownership of the investment option and other services. Under securities law, for example, revenue sharing payments from mutual funds may be called sub-transfer agency fees and/or administrative service fees. In the retirement-plan world, the phrase "revenue sharing" may be used to refer to those payments. It is important to note that not all investment options use the term "revenue sharing" as a description of these, or similar, payments.

This fee payment method involves having all or a portion of the plan fees collected through revenue sharing. Various share classes or rate levels may be available to offset greater or lesser portions of the plan fee.

It's important to note that there is no one right fee payment method. ERISA contains no provisions that specifically address how plan expenses are to be allocated among participants and beneficiaries.[4] Moreover, there is no regulation from the DOL that states any of these options is required or that one option is considered more prudent than the others.

[1] Field Assistance Bulletin 2003-03.
[2] A basis point is one-hundredth of a percentage point (0.01%). Basis points are used as a uniform measure or expression of various retirement plan fees and investment expenses, as a percentage of asset values. The relationship between percentage and basis points can be summarized as follows: 1% = 100 basis points and 0.01% = 1 basis point.
[3] Investment options may include mutual funds, insurance company separate accounts, collective investment trusts and other investments.
[4] Field Assistance Bulletin 2003-03.

Revenue Sharing Defined
There is much misunderstanding about what revenue sharing is and what it provides. As an overview, it reflects the acknowledgment by the fund company that a portion of its normal investment fee will no longer be incurred since a third-party record keeper will be providing the services being shed. For example, if a fund coming from ABC Fund Company will be marketed and serviced by XYZ Retirement Record Keeper, then fees built into the ABC fund expense for marketing and servicing would be "shared" with XYZ Retirement Record Keeper. Any amount above what the investment manager is paid is considered revenue sharing and is retained by the record keeper.

Communication Corner: Retirement Planning
This month's employee memo shows participants how much they can save between a 10- and 30-year time period and how they can increase their retirement savings by increasing their contributions by just a small percentage.

Call or email your plan consultant for more information.

About Benefits Partners
We do more than help companies get by. We elevate them through the power of collaboration and innovation. A division of NFP, Benefits Partners is a national corporate benefits organization of more than 175 offices across the country — bringing together leading-edge thinking, preferred carrier relationships, best-of-breed products, advanced benchmarking and analysis tools, and comprehensive decision and implementation support services that help keep companies ahead of the curve.

More than a leading national corporate benefits producer group, Benefits Partners is a movement that strives to bring all companies — regardless of their size — the greatest, most comprehensive and cutting-edge benefit offerings and resources in the market.

We work to give our member firms a powerful competitive advantage when providing corporate benefits for their customers. We empower collaboration and innovation on every level — from the knowledge we share, to the products we offer, to the tools we create. And we push the development of new platforms, technologies and signature solutions you won't find anywhere else.

275 Washington Street, Suite 205, Newton, MA 02458 | (627) 225-2600 | www.sapers-wallack.com

SAPERS & WALLACK

Retirement Planning

Putting Your Savings Goals into Perspective

A little bit can go a long way. The tables below show how money invested in your retirement plan can grow over time. Although this example may not reflect your current salary, the lesson remains the same: A small increase can make a world of difference in retirement.

SCENARIO 1 (Assumes a $50,000 salary and no company match)

If you contribute ...	2%	4%	6%	8%	10%
Contribution every two weeks	$38	$77	$115	$154	$192
Your contribution amount by year-end	$1,000	$2,000	$3,000	$4,000	$5,000
Account value in 10 years	$15,285	$30,570	$45,855	$61,140	$76,426
in 20 years	$49,261	$98,522	$147,783	$197,044	$246,305
in 30 years	$124,783	$249,566	$374,349	$499,132	$623,915

SCENARIO 2 (Assumes a $50,000 salary and a match of 50 percent up to the first 6 percent)

If you contribute ...	2%	4%	6%	8%	10%
Contribution every two weeks	$38	$77	$115	$154	$192
Add the employer match	$19	$38	$58	$58	$58
Your contribution amount by year-end (including match)	$1,500	$3,000	$4,500	$5,500	$6,500
Account value in 10 years	$22,928	$45,855	$68,783	$84,068	$99,353
in 20 years	$73,892	$147,783	$221,675	$270,936	$320,197
in 30 years	$187,174	$374,349	$561,523	$686,306	$811,089

275 Washington Street, Suite 205, Newton, MA 02458 I (627) 225-2600 I www.sapers-wallack.com