Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

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When "Float" is a Bad Thing

What is "float"? Float refers to the earnings or "compensation" accruing to a service provider while a plan's contribution remittance (or other assets held in suspense) is awaiting deposit or distribution.

With many service providers, a contribution received after 2PM EST will not be deposited until the next day. Any return on these remittances that are held overnight (i.e. if placed in an interest bearing account) is considered by the DOL to be "compensation" and therefore treated as such and should be disclosed as required by ERISA Section 408(b)(2). The plan sponsor, as per 408(b)(2), has a responsibility to determine whether total compensation inclusive of float is reasonable. Failure to do so may result in a prohibited transaction.

This may be a good time to inquire to your service provider as to this issue of float in order for this not to become a compliance issue down the road. The question to pose is as simple as "are there any opportunities for you, the service provider, to obtain what ERISA considers compensation for plan assets held in abeyance either for contributions pending allocation, which may be held in an interest bearing account, a forfeiture account, or a distribution check issued but not yet cashed?"

This ounce of prevention may be worth pounds of cure.

Back to the Future: Return of the GIC?

Early in the life of defined contribution plans, plan sponsors had few choices regarding their investment menu. When the Internal Revenue Code section 401(k) was first enacted in 1978 as part of the Tax Revenue Act, the most widely offered investment option was the guaranteed investment contract (GIC).

The GIC was offered by large financial institutions that paid out a set amount of interest that was "guaranteed" along with the principal. At the time, the benefits of combining a GIC with a defined contribution were touted as participants could save tax-exempt. GICs largely remained a staple of 401(k) plans until the late 1980's and early 1990's.

Gradually, fiduciaries were finding more choices, not only in the number of different GIC providers, but in alternative "cash equivalent" type options, namely money market and stable value. Fiduciaries began to see that GICs required careful due diligence at the company level.

Fiduciaries realized that it was increasingly important and even required, that they undergo enough due diligence to determine if the financial institutions providing the guarantees behind these products were financially healthy enough to support them.

Up to this point, the defined contribution plan has been more of an accumulation vehicle than a de-

-over-

accumulation vehicle. New products being created today address this issue by focusing on de-accumulation strategies; ones that generate or help manage retirement income. These new products are taking the form of in-plan annuities and guaranteed minimum withdrawal benefit (GMWB) products. They are intended to help participants minimize the risk of outliving their income and/or achieve some minimum level of income throughout retirement. There are also risks associated with each product. These are risks that plan sponsors must be aware of and ready to monitor after incorporating them into a plan.

Much like GICs, these new products are backed by large financial institutions. The financial institution gives participants who utilize these retirement income solutions some minimum level of income for life. While there are many differences between GICs and retirement income solutions, the most prominent one is with the timing of the cash flow that is "guaranteed". GICs involve a more immediate payout compared to the longer-term nature of the annuity or GMWB type product associated with retirement income products. While both types of products share similar risks, these new retirement income benefits are not accrued to the participant until they hit retirement. So plan sponsors must conduct their due diligence when it comes to considering these products.

As the industry develops the next generation defined contribution plan and the vehicles for participants continue to evolve, it may be helpful to go "back to the future" and review the lessons learned along the way. The new retirement income products of today share many similar qualities to GICs. There are, in fact, many similar concerns that a plan sponsor should consider with many of these new retirement income products. Plan sponsors need to ensure they are not only applying the appropriate due diligence into the selection of these new products, but that they are also carefully taking the right steps in monitoring of the product along the way.

How America Saves

In September 2012, Vanguard released a new whitepaper on "How America Saves 2012: A Report on Vanguard DC Plans". This is a study that Vanguard has produced since 1999. The report shows the impact of defined contribution plan trends for Vanguard's book of business that now totals over $400 billion in assets with over 1,700 plan sponsors and 3 million participants.

Despite the volatility in the markets over the past several years, participants by and large continue with their same elections year after year. More and more evidence is mounting that participants rarely change from their original elections at enrollment. While this is often viewed as good because participants are steadily participating in their 401(k) Plan, the initial contribution levels and investment choices may not necessarily be enough to actually provide a meaningful retirement. Plan Sponsors, however, have been taking steps to improve participant experiences.

Vanguard is seeing a continued rise in the use of professionally managed allocations. Typically these are risk or target date based products and they are most effectively used when participants are using them as a sole investment option, along with an appropriate consideration of either their risk or age. Vanguard has seen the use of these products grow from only about 9% in 2005 to over 33% now. Even more important is that the number of new participants using these products has grown to about 72%. In fact, Vanguard forecasts that these products will represent about 55% of all participant account balances by 2016.

Target Date funds[1] are now found in 82% of the DC plans at Vanguard. Of those, 90% of them are using the Target Date funds as the plan's qualified default investment alternative (QDIA). These continue to be an ideal choice for the typical investor as they will automatically evolve with the participant throughout their career/lifetime.

The markets ended up about flat at the end of 2011, however participants at Vanguard saw their median account balances rise from 2010 to 2011 by about 10% due to the impact of ongoing contributions. This is a

reminder to participants that they are buying shares of investments, not returns, and those shares are going to be purchased at a variety of prices throughout the year.

Automatic features continue to grow. At the end of 2011, 29% of Vanguard plans had adopted automatic enrollment, up 2% from 2010. In addition, 7 in 10 plans with automatic enrollment had implemented automatic deferral increases, up from 3 in 10 in 2005.

Participant trading in 2011 was at the lowest level Vanguard has observed since it began tracking this data in 1999. An interesting note is that only about 11% of participants actually make changes in their accounts, which means about 89% do nothing.

[1]*The target date is the approximate date when an investor plans to withdraw their money. The principal value of the fund(s) is not guaranteed at any time, including the target date. Funds objectives and investment strategies may change over time.*

Communication Corner: 401(K) Basics

This month's sample employee memo is titled, "401(k) Basics". This memo goes over 10 very common questions that plan participants ask regarding their 401(k) plan.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ (www.fiduciarybriefcase.com) in both English and Spanish versions.

Call or email your Plan Consultant if you have any questions or need assistance.

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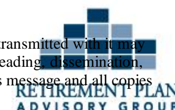

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