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Retirement Report

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

Retirement Income Solutions (RIS) with Guaranteed Minimum Withdrawal Benefits (GMWB)

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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 from 50 – 100 basis points depending on guarantee provisions).

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 also concerned about the issue of retirement readiness of the population in general. Phyllis Borzi, Assistant Secretary of the EBSA (the enforcement arm of the Department of Labor), 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?

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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 IRS considers "procedural prudence," and consists of the following steps:

1. Identify and gather information to be considered.

continued on page 3

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 (i.e. Technology in the late 1990's). 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 overweighed in specialty asset classes.

continued on page 3

Understanding Fee Methods

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 recordkeeper 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.

<u>Billed Fees</u>
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

continued on page 4

Retirement Income Solutions
continued from page 1

2. Evaluate the information as a prudent expert (hire an expert if necessary).
3. Determine the most prudent course of action to benefit participants.
4. Take appropriate action.
5. Document activity.
6. Periodically revisit the decision to ensure that it continues to be prudent.

Second, evaluate factors unique to GMWBs and RIS products:

1. 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?
2. Hedging – A significant component in RIS products, how is the hedging accomplished? What is the history and strength of their services?
3. Administrative Capabilities – What is the provider's experience administering RIS? What is the history and strength of their services?
4. Portability – What accommodations are available to participants in the event of fund or provider removal? Or upon eligibility for distribution?
5. 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 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 yet no 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.

The development of products which 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.

Specialty Asset Classes
continued from page 2

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. Where then should these assets be mapped to? 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.

Fee Methods
continued from page 2

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.

This article is an excerpt of a paper, *A Closer Look at Fee Structures: What you may not know about fulfilling your fiduciary duty*, originally published by the Principal Financial Group® in September 2013 *Thought Capital – Understanding Fee Methods.*

Revenue Sharing Defined

There is much misunderstanding about what *revenue sharing* is and what it provides. As an overview, it reflects the acknowledgement by the fund company that a portion of its normal investment fee will no longer be incurred since a third party recordkeeper 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 Recordkeeper then fees built into the ABC fund expense for marketing and servicing would be "shared" with XYZ Retirement Recordkeeper. Any amount above what the investment manager is paid is considered revenue sharing and is retained by the recordkeeper.

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.

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

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