RPAG

Retirement Times

NEWS AND UPDATES FOR RETIREMENT PLAN SPONSORS AND FIDUCIARIES

Volume XVIII | Number XVIII | August 2018

Collective Investment Trusts — The Fastest Growing Investment Vehicle Within 401(k) Plans

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For almost a century, collective investment trusts (CITs) have played an important role in the markets. They were originally introduced in 1927. A 2016 study showed that they are the fastest growing investment vehicle within 401(k) plans, with 62 percent of asset managers believing their clients will shift from mutual funds to CITs.[1]

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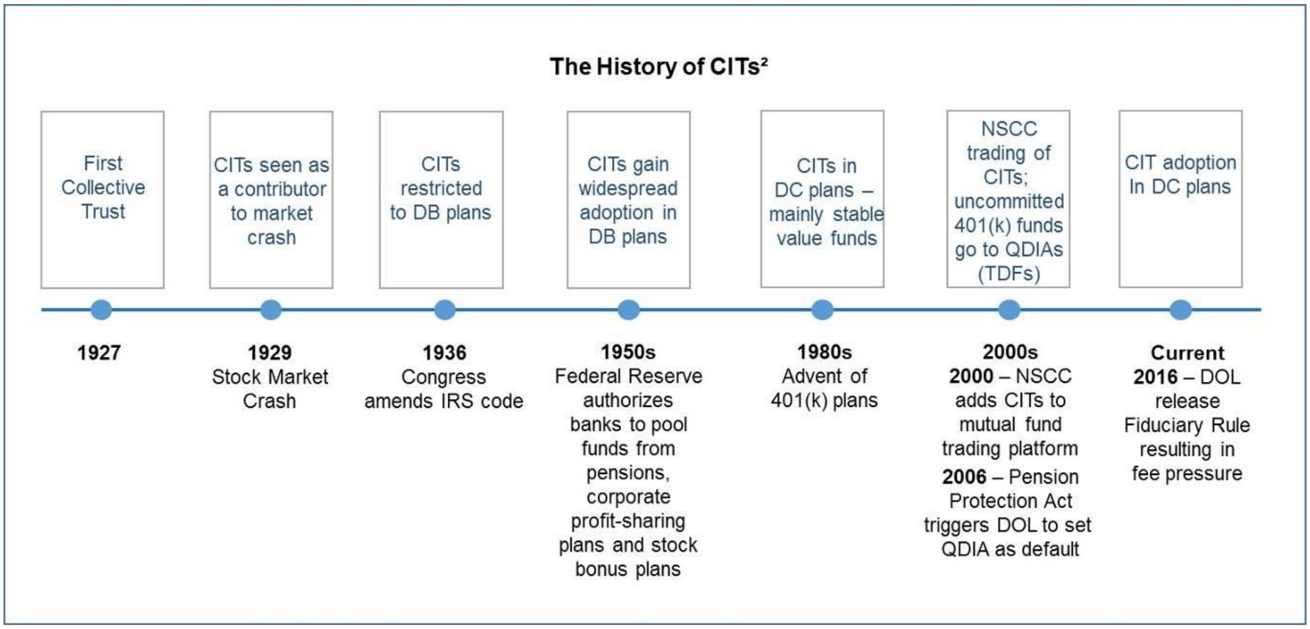
For the vast majority of their existence, CITs were available only in defined benefit (DB) plans. In 1936 CIT use expanded in DB plans when Congress amended the Internal Revenue Code to provide tax-exempt (deferred) status to CITs. CITs then gained widespread adoption in the 1950s when the Federal Reserve authorized banks to pool together funds from pensions, corporate profit-sharing plans and stock bonus plans. The IRS also granted these plans tax-exempt status.



In the 1980s, 401(k) plans became primary retirement plans and mutual funds became the primary investment vehicle, due to daily valuation. In the 2000s, CITs gained significant traction in defined contribution (DC) plans due to increased ease of use, daily valuation and availability. During this time CITs were also named as a type of investment that qualifies as a qualified default investment alternative (QDIA) under the Pension Protection Act of 2006.

From 2009 to 2014, the use of target-date CITs nearly doubled as a percentage of target-date assets, from 29 percent to 55 percent.[3]

The advantages of CITs are plentiful:

- Lower operational and marketing expenses
- A more controlled trading structure compared to mutual funds
- They're exempt from registration with SEC, thereby avoiding costly registration fees

On the other hand, CITs are only available to qualified retirement plans, and they may have higher minimum investment requirements.

While CITs have traditionally only been available to large and mega-sized plans, continued fee litigation – as well as increased CIT transparency, reporting capabilities and enhanced awareness – has amplified the allure of CITs to plan sponsors across all plan sizes. However, CITs haven't been widely available to all plans — until now.

Through your advisor's strategic partnership with RPAG, a national alliance of advisors with over 35,000 plans and $350 billion in retirement plan assets collectively[4], they can provide their clients with exclusive access to actively managed, passively managed and target date CITs, featuring top-tier asset managers[5] at a substantially reduced cost.

For more information on CITs, contact your plan advisor.

[1]*The Cerulli Report. Cerulli Associates. 2016.*
[2]*Plan Sponsors Speak With Action. Alliance Bernstein. 2017.*
[3]*DST kasina with data from Department of Labor, Investment Company Institute.*
[4]*As of 1/1/2018.*
[5]*Top-tier asset managers include BlackRock, Franklin Templeton and Lord Abbett.*

__About the Author, Alex Kahn__

Alex is an investment analyst for RPAG. He consults top-tier advisors and plan sponsors across the country on investment due diligence, with a focus on target date funds. He provides pragmatic insight on market trends and developments. Alex is also an international equity analyst for the RPAG Investment Committee and advises clients on this custom target date solution. Alex graduated with a Bachelor of Arts in economics from the Wharton School of Business at the University of Pennsylvania.

The target date is the approximate date when investors plan on withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative as the fund nears target retirement date. The principal value of the funds is not guaranteed at any time including at and after the target date.

Collective investment trusts available only to qualified plans and governmental 457(b) plans. They are not mutual funds and are not registered with the Securities and Exchange Commission.

This Won't Hurt a Bit: It's Time to Include Health Care in a Holistic Retirement Strategy

Understanding the Differences in Health Care Savings Options

Advantages (shown in blue)

ACCOUNT TYPES	PRETAX	ROTH	HSA[1]
Contributions	**Excluded from taxable income[2]**	Not excluded[2]	**Excluded from taxable income[2]**
2018 Maximum Annual Contributions[3]	**$18,500 retirement plan $5,500 IRA[3]**	**$18,500 retirement plan $5,500 IRA[3]**	$3,450 individual $6,900 family
Early Distribution Penalty[4]	**10%**	**10%**	20%
Early Distributions	Limited access[5]	Limited access[5]	**Qualified medical expenses (QME): No tax or penalty**
Taxes on Distributions	Ordinary rate	**Tax-free if qualified**	**Tax-free if qualified**
Required Minimum Distributions (RMDs)	Begin at 70½	Begin at 70½ for retirement plans[6]	**None**
Tax Treatment for Non-spouse Heirs	Ongoing tax deferral (with RMD)	**Ongoing tax-free (with RMD)**	Value immediately subject to ordinary income tax

Reflects Roth and pretax employer-sponsored plans (as opposed to IRAs) unless noted. Advantages of account type (relative to the others) shown in blue. All three types grow tax-deferred. These are not the only options when it comes to saving for healthcare and/or medical-related expenses in retirement. Note that while HSAs are structured for the individual to save or invest for health costs, this is not the intended primary purpose of a defined contribution plan or IRA. Individuals should evaluate their health coverage needs and other factors before seeking tax benefits of an HAS. Source: IRS documents.

Health care expenses are one of the most critical issues that workers and employers face today. Historically, both health care and retirement savings have largely been kept separate, but that conversation is changing. As health care is increasingly considered through the lens of financial wellness, employers need to understand the savings options. Pretax and Roth retirement account contributions, along with HSAs, are three common ways that many employees can save for health care expenses in retirement. It's important to consider the advantages of each.

HSAs Paired with a High-Deductible Health Plan (HDHP) Can Be Part of a Competitive Benefits Package

The old mantra of offering a competitive benefits package to "recruit, retain, and reward" needs updating. With an emphasis on financial wellness and health care flexibility, the "three R's" should now shift to "recruit, retain, and retire."

RECRUIT

Depending on your organization's size, offering an HSA could be seen as a differentiator, or merely table stakes, versus your competition.

- **87%** of jumbo employers,
- **72%** of large employers, and
- **34%** of small employers

…plan to offer HSAs by 2019.[7]

RETAIN

HSAs can support retention efforts for key employee demographics (e.g., healthy millennials who prefer the ability to save for their own health care expenses and executives who appreciate an HSA's tripletax advantage).

--$4,129 is the average cost of onboarding a new hire.[8]

RETIRE

Comprehensive benefits all add up to providing employees with financial support that allows them to retire when they *want* to rather than when they *have* to.

64% of employees think health care costs will impact their retirement.[9]

HSAs may help you bring value to your employees. We suggest that you:

1. Arrange for fair and balanced reviews of health care savings options, strategies, and benefits to employees
2. Review educational materials to ensure that they are clear and comprehensive
3. Connect the health care conversation to retirement and financial wellness
4. Evaluate adoption and usage data
5. Explore ways to provide employees with HSA investment education or guidance

HSAs may make sense for certain employers, especially since the **average cost** of an HSA-eligible plan is 22% LESS **than a traditional PPO**.

[1]Health Savings Account (HSA). [2]Federal income taxes. State laws vary. HSA contributions through an employer may be excluded from FICA taxes. [3]Subject to income limitations on participation (Roth IRA) or deductibility (Traditional IRA). Amounts do not include catch-up contributions. [4]Penalties end at age 65 for HSA and generally at 59½ for Roth and pretax. Distributions of contributed assets from Roth accounts are tax- and penalty-free. [5]Early distributions from retirement plans or IRAs may be subject to taxes and penalties unless an exemption applies. [6]Roth IRAs have no RMDs for original owner. [7]Mercer's National Survey of Employer-Sponsored Health Plans. Small employers have 10-499 employees, large employers have 500-19,999 employees, and jumbo employers have 20,000+ employees. [8]2016 Strategic Benefits Survey—Assessment and Communication of Benefits, SHRM 2016. [9]2017 PWC Employee Financial Wellness Survey. For additional information please reference T. Rowe Price "Using Health Savings Accounts Wisely" white paper. This material is provided for general and educational purposes only and is not intended to provide legal, tax or investment

T.RowePrice *This article was contributed by our valued partner, T. Rowe Price.*

Hey Joel!

advice. This material does not provide fiduciary recommendations concerning investments or investment management.

Hey Joel! – *Answers from a recovering former practicing ERISA attorney*

Welcome to *Hey Joel*! This forum answers plan sponsor questions from all over the country by our in-house former practicing ERISA attorney.

Hey Joel,

Is there regulatory guidance that would indicate whether forcing out terminated participants is favorable to keeping them in? What fiduciary liabilities are absolved by forcing them out (assuming this is consistent with the plan document)?

- Responsible in Rhode Island

Dear Responsible,

Great question! Assuming consistency with the plan document, there is no expanded fiduciary liability in forcing them out of the plan, as this is an allowable plan provision. As to whether cashing participants out is favorable to keeping them in, that depends on benefit to the plan or benefit to the participants.

An example would be if the plan is of significant size to have competitive expenses and access to sufficiently diverse investments including appropriately selected TDFs, it should typically benefit most participants to remain in the plan from an investment perspective.

From the viewpoint of the plan, if participants leaving the plan leave it in a less competitive pricing structure, it would benefit the plan to keep them in. Since these are low account balances, this is unlikely to be the case.

There are potential positives and negatives for both plan and participant interests, therefore it is best determined on a case-specific basis, but most typically it benefits the plan to cash out low account balances as if assets remain in the plan, the plan fiduciaries remain responsible for all prudence requirements including distributions to terminated participants. So, small account balances can be an inconvenience to the plan and fiduciaries.

Always weighing both sides,

Joel Shapiro

<u>About Joel Shapiro, JD, LLM</u>

As a former practicing ERISA attorney Joel works to ensure that plan sponsors stay fully informed on all legislative and regulatory matters. Joel earned his Bachelor of Arts from Tufts University and his Juris Doctor from Washington College of Law at the American University.

If you have a question for Joel, please send it to your plan advisor. It may be featured in a future issue!

Participant Corner: Retirement Plan Check-Up

This month’s employee memo encourages employees to conduct a regular examination of their retirement plan to determine whether any changes need to be made. Download the memo from your Fiduciary Briefcase at fiduciarybriefcase.com. Please see an excerpt below.

It’s important to conduct regular check-ups on your retirement plan to make sure you are on track to reach your retirement goals. Below are a few questions to ask yourself, at least annually, to see if (and how) they affect your retirement planning.

1. Review the Past Year

Did you receive a raise or inheritance?
If yes, you may want to increase your contributions.

Did you get married or divorced?
If yes, you may need to change your beneficiary form.

Are you contributing the maximum amount allowed by the IRS?
In 2018 you can contribute up to $18,500 ($24,500 for employees age 50 or older).

Did you change jobs and still have retirement money with your previous employer?
You may be able to consolidate your assets with your current plan. (Ask your human resources department for more details.)

2. Set a Goal

What do you want your retirement to look like? Do you want to travel? Will retirement be an opportunity to turn a hobby into a part-time business? Will you enjoy simple or extravagant entertainment?
Take time to map out your specific goals for retirement. Participants that set a retirement goal today, feel more confident about having a financially independent retirement down the road.

3. Gauge Your Risk Tolerance

Understanding how comfortable you are with investment risk can help you determine what kind of allocation strategy makes the most sense for you. Remember, over time, and as your life changes, so will your risk tolerance.

4. Ask for Help

If you have questions about your retirement plan or are unsure of how to go about saving for retirement, ask for help. Your retirement plan advisor can help you evaluate your progress with your retirement goals, determine how much you should be saving and decide which investment choices are suitable for you.

Using asset allocation as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions.