Plan Sponsor

OUTLOOK

3rd QUARTER 2012

A CURRENT ISSUES RESOURCE FOR PLAN SPONSORS AND ADMINISTRATORS

Projections for Retirement Income Improved

The Employee Benefit Research Institute (EBRI) developed the EBRI Retirement Security Projection Model in 2003 to measure retirement income adequacy. A major component of the Model is Retirement Readiness Ratings which reflect percentages of various age groups who are at risk of having insufficient income in retirement to meet basic and health-related expenses.

2012 results show progress

The 2003 Retirement Readiness Rating (RRR) showed that nearly 52% of "early baby boomers" (those born between 1948 and 1954) were at risk of inadequate retirement income. "Late baby boomers," born between 1955 and 1964, had an RRR of 49%, and Generation X members (born between 1965 and 1974) had a rating of almost 52%.

In 2012, EBRI updated the factors used in the RRR measurement and reviewed its database of 23 million 401(k) participants. The 2012 RRR for early boomers dropped to 44%, to 43% for late boomers and to 44% for Generation X.

EBRI's researchers concluded that the primary reason for the improvement in the at-risk figures is the introduction of automatic enrollment.

Savings shortfalls were estimated

Retirement Savings Shortfalls (RSS) were calculated to provide information about average individual retirement income deficits.

When looking only at participants who were projected to have an income shortfall during retirement, EBRI found that the RSS for early boomers was $70,000 per individual for married couples, $95,000 for single males and $105,000 for single females. (These estimates reflect present value at age 65 and represent the additional amount that individuals would need to have saved by age 65 to avoid a retirement income deficit)

EBRI's study is at http://tinyurl.com/EBRIRetireSecurity. ■

For a concise summary of a retirement plan sponsor's primary duties, see the Internal Revenue Service's "A Plan Sponsor's Responsibilities" at http://tinyurl.com/IRSSponsorResponsibilities.

How to Encourage Young Workers to Save

Studies have shown that workers under age 35 have the lowest participation rate in 401(k) plans of any age group, and plan sponsors constantly deal with the challenge of convincing younger employees to save for retirement. Because retirement seems so far in the future, young people tend to think of it in only abstract terms and without any urgency.

New research from the Center for Retirement Research at Boston College sought to test the premise that young people may be discouraged from saving for retirement because it's so distant for them. Several communication approaches were tested to see which ones could be effective in encouraging saving. Researchers theorized that combining abstract information about a secure retirement with a specific long-term savings goal could prove helpful to younger workers.

Individuals participating in the study viewed advertisements promoting saving for retirement. The ads varied from vague

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Minorities Borrow and Withdraw More

Economic uncertainty in recent years has led retirement plan participants to take money out of their plan accounts. A study by Aon Hewitt and Ariel Education Initiative found that minority group members do so at a significantly higher rate than non-minorities.

The authors of 401(k) Plans in Living Color: *A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups* determined, after reviewing the activities of 2.4 million employees, that nearly 9% of African-American participants received hardship withdrawals in 2010, as did 3.2% of Hispanics. Only 1.7% of Caucasians and 1.2% of Asian participants received a hardship withdrawal.

Loan activity was also higher

About half of African-American and 40% of Hispanic participants had an outstanding loan balance at the end of 2010, compared to 26% of Caucasians and 22% of Asians.

When terminating employment, most employees defaulted, and there was little difference between groups: 80% of African-Americans, 76% of Hispanics, 71% of Caucasians and 67% of Asians defaulted on their loans.

Automatic enrollment plays a key role

Researchers found that two-thirds of Hispanics and African-Americans contributed to a defined contribution plan in 2010, compared to about 80% for Caucasians and Asians.

When auto enrollment is available, 82% of African-Americans participated in a defined contribution plan, compared to only 64% when auto enrollment is not available. For Hispanics, 83% participated under auto enrollment, versus 59% in the absence of that feature.

Differences in contribution rates seen

African-Americans who were enrolled automatically contributed an average of 4.3% of pay, compared to 6.3% for those not automatically enrolled. Hispanics contributed 4.4% of pay under auto enrollment, versus 6.6% without it.

Caucasians averaged a 5.2% contribution rate under auto enrollment, but 8% when not automatically enrolled. Asians who were automatically enrolled contributed 7.3% of pay, compared to 9.4% for those who enrolled voluntarily.

The authors concluded that the relatively lower contribution rates under auto enrollment were due to the tendency of employers to set contributions at a very low rate. For example, half the plans in the survey enrolled workers at rates between 1% and 3%.

401(k) Plans in Living Color is at http://tinyurl.com/AonHewittSavingsDisparities. ■

Separate study found similar results

A separate survey of the activities of 250,000 participants yielded similar statistics. *Diversity and Defined Contribution Plans: Loans and Hardship Withdrawals* found that African-Americans were 55% more likely than non-minorities to take a loan or hardship withdrawal. Hispanics were about one-third more likely than non-minorities to do so.

Loan amounts were only slightly higher among African-Americans, Hispanics and Asians than Caucasians.

This research is available at http://tinyurl.com/DiversityLoans.

How to Encourage Young Workers to Save

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directions (for example, "…you may need to set up a retirement account…") to specific steps regarding how to enhance savings, such as set a 15-percent-of-pay goal and invest in one balanced fund. Tables indicating short-term and long-term targets, based on salary amount, were also shown.

The results indicated that younger workers were more responsive to the advertisement that proposed the long-term savings goal (for example, a goal of $337,500 saved over 45 years by a person with a $50,000 salary). But, they also responded well to the ad with the short-term goal: a bi-weekly payroll deduction.

The researchers concluded that appealing to younger employees' abstract way of thinking will likely be effective in encouraging them to start saving or to save more. This approach, combined with describing a savings goal presented as a short-term target, such as the amount to save from each paycheck, may be even more effective.

How Can Employers Encourage Young Workers to Save For Retirement? is at http://tinyurl.com/CommunTechniques. ■

Pension Plan Limitations for 2012

401(k) Maximum Elective Deferral (*$22,500 for those age 50 or over, if plan permits)	$17,000*
Defined Contribution Maximum Annual Addition	$50,000
Highly Compensated Employee Threshold	$115,000
Annual Compensation Limit	$250,000

Plan Sponsors Ask...

Q: What are key consequences we should point out to participants who request a hardship withdrawal?

A: Hardship withdrawals must be used solely to resolve an immediate and heavy financial need, and must be limited to the amount required to satisfy that need.

The safe harbor for hardship reasons includes medical expenses, purchasing a principal residence, tuition and related expenses for post-secondary education, payments to avoid eviction or foreclosure, funeral expenses and certain expenses to repair a principal residence.

A major consequence of receiving a hardship withdrawal is that the recipient is suspended from making elective deferrals to the 401(k) plan for six months. This suspension applies to both pre-tax and after-tax Roth contributions.

Another result is that the participant loses the employer match on his or her contributions during the suspension.

A third consequence is the immediate tax liability. Income tax is due on the amount withdrawn, as well as a 10% early withdrawal penalty if the participant is under age 59½.

Lastly, the participant misses the potential for compounding investment gains over time. At retirement, that could mean thousands of dollars.

Obviously, participants need to be aware that a hardship withdrawal should be requested only as a last resort.

Q: Has the Department of Labor issued guidance regarding the participant-level fee disclosure regulations?

A: Yes. In May, 2012, the Department of Labor released a Field Assistance Bulletin (FAB) that contains nearly 40 questions and answers designed to supplement the final rules.

The FAB includes practical guidance for plan sponsors on topics such as the level of detail required in the disclosure of plan administration expenses, how to handle expenses paid from forfeitures, revenue sharing explanations and alternatives to the website requirement.

Also, rather than provide an approved glossary, the Department of Labor refers sponsors to glossaries available from industry groups, such as the one prepared by the SPARK Institute and the Investment Company Institute, which has been widely endorsed.

Field Assistance Bulletin No. 2012-02 is available at http://tinyurl.com/DOLFAB2012-02.

Q: Overall, how active were participants with respect to transactions within their defined contribution plans last year?

A: The Investment Company Institute (ICI) analyzed the activities of more than 23 million 401(k) plan participants in almost 64,500 plans in 2011 and issued a Research Report summarizing the results.

The ICI analysts found that only about 3.5% of participants took withdrawals in 2011, which is almost the same rate as in 2010. Similarly, only 1.7% received hardship withdrawals in both 2010 and 2011.

The number of participants with outstanding loans moved up slightly. In 2011, 18.5% of participants had loans at the end of the year, compared to 18.2% in 2010 and 16.5% in 2009.

Only 2.7% of participants discontinued making contributions in 2011, versus 2.4% the prior year.

The ICI's report, *Defined Contribution Plan Participants' Activities, 2011* is at http://tinyurl.com/ICIParticActivities2011. ■

The average expense ratio incurred by investors in long-term mutual funds and index funds declined in 2011, according to the Investment Company Institute's *Trends in the Expenses and Fees of Mutual Funds, 2011*. See the full report at http://tinyurl.com/ICIFundFees2011.

Web Resources for Plan Sponsors

Internal Revenue Service, Employee Plans
www.irs.gov/ep

Department of Labor,
Employee Benefits Security Administration
www.dol.gov/ebsa

401(k) Help Center
www.401khelpcenter.com

Plan Sponsor Magazine
www.plansponsor.com

BenefitsLink
www.benefitslink.com

Plan Sponsor Council of America
www.psca.org

Employee Benefits Institute of America, Inc.
www.ebia.com

Employee Benefit Research Institute
www.ebri.org

Target Date Funds Reduce Investing Extremes

Analysis of the asset allocations of 3.2 million defined contribution plan participants indicated that target date funds' growth in usage has significantly lowered the extreme allocations some participants had in the past.

In 2004, 35% of participants had extreme allocations: 22% invested solely in equities and 13% had no equity investments at all. In 2011, only 18% had such extremes, with 10% having only equities and 8% with no equities.

By 2011, one in four 401(k) participants invested only in target date funds. And 64% of new participants invested in a target date fund.

Nearly 50% of participants had an investment in target date funds in 2011, with 24% invested in only one of these funds. About 27% of plan contributions went to target date funds.

Target Date Fund Adoption in 2011 is available at http://tinyurl.com/TargetDateFunds2011. ■

PLAN SPONSOR'S QUARTERLY CALENDAR

OCTOBER

- Audit third quarter payroll and plan deposit dates to ensure compliance with the Department of Labor's rules regarding timely deposit of participant contributions and loan repayments.
- Verify that employees who became eligible for the plan between July 1 and September 30 received and returned an enrollment form. Follow up for forms that were not returned.
- For calendar year safe harbor plans, issue the required notice to employees during October or November (within 30-90 days of the beginning of the plan year to which the safe harbor is to apply). Also, within the same period, distribute the appropriate notice if the plan features an EACA (Eligible Automatic Contribution Arrangement), QACA (Qualified Automatic Contribution Arrangement) and/or QDIA (Qualified Default Investment Alternative).

NOVEMBER

- Prepare to issue a payroll stuffer or other announcement to employees to publicize the plan's advantages and benefits, and any plan changes becoming effective in January.
- Conduct a campaign to encourage participants to review and, if necessary, update their mailing addresses to ensure their receipt of Form 1099-R will be mailed in January for reportable plan transactions in 2011.
- Check current editions of enrollment materials, fund prospectuses and other plan information that is available to employees to ensure that they are up-to-date.

DECEMBER

- Prepare to send year-end payroll and updated census data to the plan's recordkeeper in January for year-end compliance testing. (Calendar year plans)
- Verify that participants who terminated during the second half of the year selected a distribution option for their account balance and returned the necessary form.
- Review plan operations to determine if any ERISA or tax-qualification violations occurred during the year and if using an IRS or DOL self-correction program would be appropriate.

Consult your plan's financial, legal, or tax advisor regarding these and other items that may apply to your plan.

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