



# The Advisor

## 401(k) Inside and Out



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## **Best Practices: Renegotiating Fees Remains Single Most Effective Tool in 401(k) Plan Cost Control**

Increasingly, 401(k) plan sponsors are focusing on plan fees and renegotiating with existing service providers to keep costs down. A full 43.4% of sponsors participating in IOMA's 2005 401(k) Plan Costs Survey have found the most success with this approach, up from 40% in 2004 and 32.8% in 2003.

As the principal compensation and benefits analyst at a high-tech manufacturing company told us, "we hired an outside consultant to review the fees participants were paying for each of our funds". As a result, the recordkeeper moved nine funds into a lower cost share class with lower basis points and dropped the distribution fee," the analyst for the 3,400-employee company in Virginia added.

"We are a growing company," noted the senior vice president of human resources at a wholesale/retail/distribution/trade company in Idaho. "As we've grown, we've been able to leverage our size of corresponding 401(k) balance to get lower fees." This has allowed us," the representative of the 3,000-employee company said, "to take advantage of the lower fees by offsetting against plan expenses while still reducing cost to participants."

Adds the vice president of a 45-employee finance/banking firm in Wisconsin, "we annually review the fees charged by the

provider, review our specific plan demographics, and revisit where costs can be reduced. Assets increase each year, allowing for the potential of reduction each year."

Coming in second for best cost-control measures was changing recordkeepers, investment managers, and consultants. This year, 34.1% of plan sponsors cited this as their most successful approach, up slightly from the previous two years.

"We've changed to investment managers/recordkeepers who use lower costing index funds," the CFO at a 65-employee non-profit company in Washington told us. "The financial benefit," he continued, "is that it saved both the employer and the employees money. Savings were over 25% on average per employee."

Selecting a new recordkeeper that offered Web-based enrollment, loans, distributions, investment selection, and deferral changes opened up an enormous amount of time for the benefits area, the supervisor of benefits administration at a manufacturing/mining company in Pennsylvania told us, "at one time, we had one person dedicated to just 401(k)". "Now this person is free to do many other projects."

### **Plan Consultant Scrutiny**

New to our survey this year was the cost-control option of overseeing plan consultants' fees more closely. Clearly, sponsors were worried over the Security and Exchange Commission's (SEC) finding in May that the U.S. pension consultant industry is full of potential conflicts of interest, including nondisclosure of fees paid by money managers to plan consultants.

"Although investment advisers owe their clients a fiduciary obligation—including to adequately disclose all material conflicts of interest—some pension consultants appear to have erroneously concluded that they are not fiduciaries to their clients," the *Staff Report Concerning Examinations of Select Pension Consultants* found.

Nearly 30% of our survey respondents said this was their most successful means of controlling plan costs, placing it as the third most effective measure.

This finding of conflict of interest, in fact, spurred the Department of Labor to issue 10 tips to assist fiduciaries of employee benefit plans in reviewing conflicts of interest of pension consultants, a tool plan sponsors have revealed to IOMA that they are using.

## Best Practices: Renegotiating Fees Remains Single Most Effective Tool in 401(k) Plan Cost Control *(continued From Page 1)*

More sponsors, too, are making administrative changes to their plans to control costs. This year, in fact, 24.9% of 401(k) plan sponsors said they were changing or charging loan fees to participants, up from 22.7% last year.

### Web Help

Web-based changes came next in popularity to control costs, with Web-based plan enrollment (22%), Web-based deferral changes (20.8%), and Web-based loans (20.8%), placing five, six, and seven on the list of effective plan cost-control approaches.

As the retirement plan administrator at an 800-member private practice firm in Illinois revealed, automated Web-based enrollment and changes has been their most successful tool in controlling costs over the past two years. "Our service provider continues to offer more Web-based service options. This allows us to administer the plan more efficiently and allows our participants to manage their accounts directly. These services have saved us so much time that we've been able to eliminate one part-time administrative position."

"By using Web-based loans, account changes, and inquiries, we have saved

the time of our plan administrator and the service providers," noted the HR/PR director at a utilities/communication/transportation company in North Carolina. "We sent out information in our newsletter, in the employee checks, and in participants-account statements, and we offered to assist any one of our 101 employees needing one-on-one help."

### Plan Size Differentials

Renegotiating services fees with existing providers was a strategy, which, although used across the board, was most favored by larger companies. Sponsors with 1,500 or more employees used this approach 51.7% of the time versus the 31.3% of firms with up to 99 workers.

Companies with 100 to 299 employees cited the most cost-control success in changing recordkeepers, investment managers, and consultants (39.3%) as their most effective cost-control technique, outpacing the overall average by 5.8%.

And plan sponsors with 300 to 1,499 workers were most concerned (32.6%) with plan consultants' potential conflicts of interest. However, nearly one-third of all-sized companies listed this as a key cost-control measure.

Smaller plans with up to 99 employees were also far more likely to adopt safe harbor plans (25%) versus the overall average of 16.8%. These plans eliminate the need for actual deferral percentage (ADP) testing in exchange for a 3% match on deferrals. As a midsize financial/banking company in New York told us "when we changed our plan two years ago, we added provisions to make it a safe harbor plan. Working with our outside counsel, we reviewed our options when we switched from a profit sharing to a profit sharing with a 401(k) plan."

The company decided it was cheaper and less time consuming to provide a 3% company contribution. "To date," the company noted, "this strategy has worked."

While industry experts have commented that the proliferation of 401(k) investment options may be too confusing for most participants, few sponsors cited their cutback as having the most success in controlling plan costs. Only 5.8% overall cited this option, with plans of 100 to 299 employees being the most inclined to do so (10.7%).

## Key Benchmarks to Judge Your 401(k) Plan

Plan sponsors are always on the lookout for 401(k) benchmarks to better assess how their plans stand up to others. It comes as no surprise then that Linda Holleman's Benchmarking 2005 session at the recent Profit Sharing/401(k) Council of America's (PSCA) 58th National Conference in San Diego was one of the most anticipated and attended.

Holleman, a consultant with Aon Consulting (Chicago, [www.aon.com](http://www.aon.com)), looked at data on participants, plan sponsors' concerns, and plan design considerations from a variety of surveys. At the outset, Holleman warned plan sponsors to be keenly aware that the way baby boomers are defining retirement is very different from generations before.

A Merrill Lynch study of employees age 40 to 58 reveals that more than 50% of the baby boomers have the word "work" as part of their plan for retirement. It is cycling between work and leisure, working part-time or working full-time. "The extent to which you can structure your company to take advantage of that may be in your best interests," she added, noting that it may help sponsors communicate to employees if they have an idea about how they are thinking about retirement. "In addition, it may guide sponsors in structuring changes in their qualified plans or policies to help employees reach their retirement goals and not have a brain drain in your company."

Why do people want to work in retirement? Staying mentally and

physically active tops the list for men and women, but other factors—like retaining health insurance—also play a role. And while money was only listed by 31% of males and 42% of females, it may very well be quite an important factor.

### Where Do Participants Stand?

Fidelity Retirement Index, a study of full-time employees' complete financial resources, reveals that, on average, households are on track to replace 59% of their income.



## Key Benchmarks to Judge Your 401(k) Plan

Only 15% of households are on track to replace 85% of income, the industry agreed-upon standard for needed retirement income replacement. "Clearly cycling between work and leisure may be needed to supplement this," Holleman added, particularly when only 44.1% of plan participants know that this amount is needed.

### Plan Sponsor Concerns

As for plan sponsor concerns, fiduciary worries top the list with two key areas being paramount in their minds: investment monitoring and vendor management/service provider oversight.

As PSCA's just released survey of profit sharing and 401(k) plans reveals, over the years, the percentage of sponsors who have an investment policy is growing. In 1999, 54% of sponsors had an investment policy versus 32% that did not. In 2004, that split was 74% versus 16%.

"Once you have a statement, it says what you are going to do to monitor investments and you have to do that. So just how are sponsors monitoring their investments?" asked Holleman.

A Deloitte survey shows that over half of the companies do quarterly monitoring (58%). "More frequent monitoring is definitely the trend and is becoming the best practice with semi-annual and then annual following," Holleman noted.

And who does the monitoring? Most companies take several approaches. "A lot of companies will use an outside investment consultant to do the initial monitoring, prepare the reports, and present those to an internal investment committee. Some companies also use the recordkeeper to provide this basic information for investment review."

And how are underperforming funds handled? Sponsors handle underperforming funds in stages. Fifty-five percent said they would replace the fund; 47% would continue to monitor the fund, "which is a perfect thing to do when you first become concerned about it," Holleman added. Another 10% would phase it out over time, and 13% would add another fund with a same investment style. Twelve percent would freeze the fund.

When it comes to the mutual fund scandal and subsequently imposed trading restrictions, only about a quarter of plans have investment options that assess short-term trading fees. And only 23% had restrictions on the frequency of inter-fund transfers among investment options. More have investment options that restrict frequency of trading in and out of funds (36%), but are still a minority, the Deloitte survey revealed.

If restrictions are in place, who monitors them? In half the plans, the recordkeeper monitors the restrictions "and frankly," notes Holleman, "they are in the best position to do so." In some instances, the sponsor or the fund company did.

What are participant consequences of excessive trading? The largest majority of plans (33%) notify participants of the plan's policy and are advised to stop. A much smaller percentage (13%) actually freeze that account for further trade. This often happens when the participant ignores the warning and continues to trade excessively, she noted.

*Service provider oversight.* 401(k) plan sponsors need to be sure they are getting good service and that the fees are reasonable for the services received. Yet only 39% of plan sponsors said they put fees at risk if certain service levels weren't met; 40% did not; and 21% didn't know.

"Fees at risk," she noted, "are becoming fairly common especially in some areas. But even if you don't have fees at risk, you need to establish service levels and then monitor those service levels to make sure that you and the participants are receiving the level of service that you expect." Those levels of service being monitored range across the board, with accuracy, statement turnaround time, call center measurements, and distribution processing time taking the lead.

### Plan Design Considerations

*Participation.* Participation over the past four years hasn't moved much. In 2004, it was 77%, as PSCA's latest annual survey reveals, up 1% from last year.

*Automatic enrollment and easy enrollment.* Easy enrollment makes it very simple for participants by setting a default percentage and default investment fund. All the employee has to do is sign his or her name and check a box to be part of the plan. For this purpose, sponsors typically use postage-paid post cards. "Easy enrollment is something plan sponsors are using if they are concerned about any fiduciary responsibility automatic enrollment could cause them," according to Holleman.

Deloitte compared the two concepts. Fourteen percent of sponsors use automatic enrollment; 10% use easy enrollment. In addition, 14% said they are considering automatic enrollment, and 9% are considering easy enrollment.

Looking at the default deferral amount for these two types of plans, automatic enrollment plans most frequently use 3% of pay (55%), whereas easy enrollment programs are split 32%/32% over 2% of pay and 3% of pay.

As for the default investment election, both types of plans favor short-term investment options like stable value or money market funds (58% automatic enrollment and 64% easy enrollment). Only 17% of automatic enrollment plans used lifestyle or target retirement funds versus 32% of easy enrollment programs.

Motivations differed slightly for adding these plans, with sponsors more inclined to cite encouraging retirement savings for automatic enrollment plans (42% versus 24%), and easy enrollment plans stressing increasing overall participation (57% versus 40%).

*Average contribution rates.* And just what are employees' average contribution rates? According to PSCA, pre-tax rates for higher paid average 6.7% and 5.4% for lower paid, whereas after-tax contributions average 3.2% for higher paid and 2.6% for lower paid.



## News Briefs (December 2005)

### IRS Announces Cost-of-Living Increases for 2006 Pension Benefits, Contributions

The Internal Revenue Service announced the 2006 annual cost-of-living adjustments for pension benefits and contributions to retirement plans:

- The maximum deferral to 401(k) plans will increase from \$14,000 in 2005 to \$15,000 in 2006;
- Catch-up contributions under EGTRRA for employees 50 and older will increase from \$4,000 to \$5,000;
- The compensation limit under Code Section 401(a)(17) increases from \$210,000 in 2005 to \$220,000 in 2006;
- The annual addition contribution limit under Code Section 415 for individuals in 401(k) plans increases from \$42,000 in 2005 to \$44,000 in 2006;
- The highly compensated employee limit under Code Section 414(q) is increased from \$95,000 in 2005 to \$100,000 in 2006;
- The limit used in determining key employees under Code Section 416 is increased from \$135,000 in 2005 to \$140,000 in 2006; and
- The Social Security Wage Base (maximum earnings taxable) for 2006 is \$94,200.

### Boomers Increasingly Anxious About Retirement

*The MetLife Survey of American Attitudes Toward Retirement: What's Changed?* shows baby boomers are increasingly anxious about retirement. The new study reports that the number of boomers "worried about retirement" has doubled since 2001, with younger members, ages 41 to 49, more likely to voice concern.

"While it is troubling that boomers are concerned about finances, perhaps more worrisome is that fewer are taking the steps necessary to ensure financial security in retirement," said Sandra Timmermann, Ed.D., director of the MetLife Mature Market Institute. Only two-thirds (66%) of those surveyed believe they are saving at the rate needed to maintain their lifestyle, a decline from 77% in 2001.

Boomers are delaying retirement until they believe they will have enough money to retire. In 2001, they believed they would retire between ages 55 and 64. Today, the median retirement age is between 65 and 70. Sixty percent would prefer to retire before age 65; 17% say they will keep working indefinitely, a 10% increase.

### Plan Participation Plagued by Eligibility Misunderstandings

According to a recent Congressional Research Service (CRS) report, low participation in retirement plans may be due to employees' misunderstanding of plan eligibility. In its *Retirement Plan Participation and Contribution* report,

CRS found that 28% of the employees said they hadn't worked long enough for their employer to be eligible, 29% said they didn't work enough hours, and 9% said their job wasn't covered by their employer's plan. Yet 24% who felt they hadn't worked long enough had actually been with their employer for more than two years, and 35% who said they didn't work enough hours actually worked full time. Lastly, 41% said they worked 35 or more hours per week.

### Average 401(k) Balance Rose 36% From 1999 to 2004

Americans who continuously maintained 401(k) accounts from 1999 to 2004 saw their balances increase by an average of 36% over the five-year period despite enduring one of the worst bear markets since the Great Depression. Among this group, the average account balance increased 15% in 2004, according to *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2004*, a study released by the nonpartisan Employee Benefit Research Institute (EBRI) (Washington, D.C.; [www.ebri.org](http://www.ebri.org)) and the Investment Company Institute (ICI). But the study noted that the averages varied widely by age; increases reflected added contributions and the impact of equity market changes on account assets.

The EBRI/ICI 401(k) database, the largest of its kind, showed that average account balances rose to \$91,042 at year-end 2004 from \$67,016 at year-end 1999 for those who maintained accounts for the entire period. "Consistent participation has had a significant impact on individuals' ability to accumulate sizeable gains in 401(k) account balances since 1999," the study said.

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