



# The Advisor

## 401(k) Inside and Out



**CLEARPOINT**  
Financial

**720 Olive Way**

**Suite 1700**

**Seattle, WA**

**98101**

**(206) 962-2000**

**Boston:**

**(617) 965-1795**

**Minneapolis:**

**(612) 373-7040**

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## Automatic 401(k) Enrollment — Do the Benefits Outweigh the Possible Downfalls?

Plan sponsors have long struggled with the issue of encouraging more plan participants to take control of their financial future by contributing to their 401(k) plan. As retirement savings vehicles go, a 401(k) plan can be one of the best tools an individual can use in reaching their long-term financial and retirement goals. However, like any good tool, an individual must first use it to realize its full potential.

Many plan sponsors spend a great deal of time, energy, and perhaps dollars educating staff on the benefits of the company's 401(k) plan and the importance of saving for retirement. Oftentimes lack of participation can also have a negative effect on a plan's nondiscrimination testing.

To address this issue, many 401(k) plan sponsors have begun to add an "automatic" enrollment feature to their company's plan. Automatic enrollment, also referred to as "passive" or "negative" enrollment, allows the employer to automatically enroll employees into its 401(k) at a specified contribution and investment percentage upon meeting the plan's eligibility requirements. These preset contribution percentages remain in effect until the employee instructs otherwise.

There are benefits to automatic enrollment for both the employer and employee. For the employer, automatic enrollment has the

potential to increase the likelihood of successfully passing nondiscrimination testing due to the increased participation rate of the non-highly compensated employee base. At the same time, employees will benefit from automatic enrollment, as the money they defer will go toward meeting their retirement goals. In addition, they may also benefit from employer contributions if the company matches salary deferrals.

Of course, there are potential issues associated with an automatic enrollment feature. The plan sponsor will have to communicate to participants what is involved with automatic enrollment. IRS Revenue Rulings 98-30 and 2000-8 outline the steps that plan sponsors must take to notify their employees of the automatic enrollment feature. Upon hire, the plan sponsor must advise employees of the following:

The default salary deferral percentage that will apply and be deducted from their pay.

Their ability to change the initial default contribution, with specific instructions on how and when to do so.

Their right and instructions on how and when to elect out of making contributions at all.

In addition, these notifications must be made annually to all participants that remain in automatic enrollment status.

The plan sponsor is also responsible for choosing the appropriate default investment option should the plan participant not elect their own desired allocations. What that default investment option should be is the subject of much debate. Selecting a relatively low-risk investment, such as a money market or stable value fund, may seem prudent to avoid the potential risk of placing a participant's dollars in an investment that exceeds his/her risk tolerance level. However, one could also argue that in order to meet the long-term investment goals of many participants, a money market or stable value fund may be too conservative and, therefore, not prudent.

An automatic enrollment feature can be a great way to increase plan participation and help ensure that plan participants are deferring money to work toward achieving their financial goals. At the same time, plan sponsors must consider the issues that arise when using an automatic enrollment feature. If you are contemplating and/or are interested in adding an automatic enrollment feature to your plan, it is highly recommended that you discuss the pros and cons of such a feature with your 401(k) consultant.

## PLANSPONSOR Magazine: IMHO: The Best Test

Plan sponsors understandably rely on experts to assist them in their Herculean task, and ERISA contemplates that reality. Unfortunately for plan sponsors, the standards in selecting and monitoring, on an ongoing basis, the skills and actions of those experts can be almost as daunting as the underlying activities themselves.

In the midst of these challenging times, financial advisors have become a ubiquitous element in many markets. Absent their presence, many small-plan sponsors might still lack access to a respectably priced retirement plan, and the in-person delivery of education and advice to plans certainly would suffer across the board. Providers also benefit from the cost-effective delivery of services to places that are far-flung, and perhaps ill-served by distant call center support.

Unfortunately, plan sponsors have little to go on in evaluating a financial advisor before the fact. The geographic diversity that is their strength also serves to thwart a ready assessment of their skills. Their service is delivered to a finite group of plan sponsors, rendering statistical evaluations challenging at best. Over the

years, plan sponsors have repeatedly asked me for recommendations on financial advisors but, up until recently, I've been hard-pressed to provide any suggestions.

A year ago, PLANSPONSOR announced its inaugural Retirement Plan Advisor of the Year award. That award was designed to recognize "the contributions of the nation's best financial advisors in helping make retirement security a reality for workers across the nation." While we looked to experience, commitment to the business, education, and employer referrals, at the outset, we wanted the award to focus on objective criteria that made an impact on ensuring retirement security. More specifically, we looked for evidence of increased participation rates, enhanced rates of participant deferrals, improved asset allocations, and either reduced fees or expanded service levels—the criteria that have, for years, been most highly sought by plan sponsor respondents to our Defined Contribution Survey.

During the course of the RPA evaluations, we were impressed by

stories of plan participation rates that jumped 20% to 30% in a six-month period; participants that have, in many cases for the first time, "rational" asset allocation choices; investment committee members who, for the first time, not only regularly attended investment review meetings, but also looked forward to them; and the extraordinary measures taken by advisors to ensure that even relatively small 401(k) plans gain an audience with the heads of mutual fund complexes tainted by the trading scandal. Ultimately, more than 200 advisors nationwide were nominated. A listing of the 25 "Most Successful" advisors in the November issue of PLANSPONSOR represented assets of nearly \$45 billion under advisement.

This month, we launch our second annual RPA award and, once again, seek your help in identifying the best and brightest in the space—because, in the final analysis, the best test of a financial advisor's skills is the way in which he or she helps you fulfill your responsibilities to your participants.

We Congratulate *PLANSPONSOR* Retirement Plan Advisor of Year, **Dorann Cafaro** and Finalists **Larry Deatherage** and **Anthony Franchimone**.

We Also Congratulate our Other Five NRP/401(k) Advisor USA Member Firms For Being Nominated by *PLANSPONSOR MAGAZINE* As the Retirement Industries Top Advisors.



# Basic Steps for Fiduciary Compliance

ERISA requires that fiduciaries, such as the committee members or corporate officers who make decisions about the plans, engage in a prudent process to manage and monitor retirement plans. As a starting point, fiduciaries are required to look at the right information (substantive prudence) in the right way (procedural prudence), but that begs the question: What is "right"?

It is too large a task to define "right" for all fiduciary issues in all cases. Let's consider just one—what is right for monitoring investments?

As a road map, I have developed six basic steps for fiduciary compliance and best practices. The first four are practical steps to minimize the legal risk of fiduciary liability; the last two are "best practices" that protect fiduciaries and satisfy ERISA's expectations.

1. Meet at least once a year. This assumes that a plan committee has been appointed and that it consists of competent people. (If that has not been done already, then the first step is to set up a committee.) The plan's primary advisor on investment matters should attend the committee meeting.

2. Produce a written report covering, at the least, the investments. Also, I recommend that the report, or another written report, cover usage of the investments by participants. That report also should review the usage and effectiveness of investment services such as investment advice, participant

education, and so on. For example, are participants diversifying adequately among the investment choices? Are they overinvested with conservative options, or in company stock? Any of those patterns could indicate a problem.

3. The committee members should obtain and read the report(s) before the meeting and, if there are any recommendations, they should consider them. The committee members need to understand the report well enough to make informed decisions. They should ask questions where they do not understand the data or recommendations, and the advisor should either answer those questions or obtain the answers. Once that process is complete, the committee must make informed and reasoned decisions about the plan's investments and investment services. For example, if the plan is operating properly, the committee could decide to continue the status quo for another year. However, the committee members cannot rely "blindly" on the report. They must understand it and adopt it as their own. As a practical comment, the existence of a written report ordinarily would provide substantial evidence of due diligence by the fiduciaries.

4. Minutes of the committee meeting should be prepared. They should be drafted in a conclusive style. That is, they should be limited to describing the materials reviewed, the issues discussed, and the decisions made. There is no need for a detailed report of individual comments made during the discussions. The minutes, together with the report,

should be placed in a due diligence file, which should be kept for at least seven years.

5. As a best practice, the committee should discuss whether the plan is being operated successfully. That is, is it a successful plan in the sense that it has a high level of participation, high rates of deferrals, and prudent participant investing? The committee members and the advisor should discuss alternatives for improving any or all of those areas, and decisions should be made and implemented.

6. Finally, the committee should review the investment policy statement and determine whether it continues to be appropriate for the needs of the plan and the participants. If it needs to be improved, then it should be amended accordingly.

While a short checklist cannot capture all of the issues and considerations for monitoring a plan's investments, this is a good start toward both fiduciary compliance and a successful plan. If a committee completes this process, makes decisions, and then implements those decisions, it will have gone a long way, and perhaps all the way, toward fulfilling its fiduciary duties for the plan investments—until the next year, when the committee needs to repeat this process, including the monitoring of the decisions it made and implemented the year before.

## How to Build an Effective 401(k) Education Program

### 1. Focus on savings and wealth, not retirement

Salisbury suggests that 401(k) plan sponsors should reconsider the emphasis their education programs place on retirement, especially when they are targeting the message to younger workers.

"One of the things that comes up," he explains, "is that it would probably be beneficial to stress the 'R' word less than has been done in the past and increase the stress on the 'S' and 'W' words. Cut the stress on retirement and increase the stress on savings and wealth. And tell people of

all ages that savings and wealth give independence and control."

To many young workers, he says, the idea of putting money aside for retirement is "a foreign concept." They therefore are less likely to invest in their company's 401(k) plan than they might be if they conceived of their plan assets as accumulating savings and enabling them to achieve financial independence.

### 2. Put less attention on asset allocation

Salisbury also recommends that education

programs be restructured to accentuate savings rather than asset allocation. Today's 401(k) education programs often revolve around helping participants decide what type of investments they should select for their assets.

"Asset allocation is irrelevant if you have no money to allocate," he says. "The numbers end up showing the biggest challenge is really getting people to save the money and contribute enough." Education dollars should be directed at those not participating or saving too little, rather than on participants who already are saving sufficiently and need help deciding where to invest.

### 3. Personalize education programs

Salisbury recommends that sponsors personalize education programs and offer several channels for reaching participants. "If 401(k) providers and plan sponsors want to get directly to the individual, there is a premium on multiple media," he says. "The results [of the survey] make it clear that, particularly among lower educated and lower income groups, the written word is highly valued, and the personal touch is highly valued."

That means that the most successful education efforts are generally those that offer one-on-one, personalized sessions with workers.

In that regard, Salisbury recommends holding lunchtime seminars as a way to get in touch with individual participants. While there has been a trend toward personalization in recent years, too many plans still rely on the Internet to educate participants about investment options and retirement planning.

### 4. Confront unrealistic expectations

At the same time, however, the country's workers are unrealistic about how much money they will need during their retirement years; often believe they can prolong their careers beyond what is likely to actually be the case; do not expect their own standard of living to decline once they leave the workforce; and look to government and their employers for more help with their financial security in retirement.

Even though more than half of all workers plan to continue holding jobs until they are at least 65, only 31% of people who already have retired actually worked that long. That indicates a great urgency for 401(k) education plans to give workers a realistic portrait of how long they are likely to continue working

and how much they will need to live on once they have retired.

Currently, according to the authors of the survey, "many workers appear to have optimistic expectations about retirement and retirement income that might lead them to be complacent about their retirement savings needs."

For example, few workers who expect to work into or beyond their mid-60s contemplate that they might be laid off or have to cease working for health reasons. They therefore are unlikely to have sufficient retirement assets if they leave the workforce before they had anticipated.

### 5. Beef up retirement planning

Perhaps the most critical parcel of any provider's retirement education package should be, at the very least, to get participants thinking about planning financially for their postwork lives. But, according to the EBRI survey, "Workers have not given much thought to key retirement issues."

Despite the extreme difficulty many American workers will face surviving adequately off the meager savings they will have accumulated in their 401(k) plans, they are doing little to rectify the situation. Only 27% of those enrolled in plans increased the percentage of their salary that they contributed to their 401(k) plans last year. Although many, especially those who actually decreased their contribution level, cited financial constraints as a reason for not boosting their contribution levels, they are likely to face even more dire circumstances during their retirement years.

### 6. Get personal

Workers cited having individual access to a financial planner as most helpful in their retirement planning considerations, followed by seminars or group meetings and retirement benefit statements. Educational tools such as online investment advice, other online services, and software programs were far down the list of helpful materials.

That's why it's possible that too many plans today have placed too much emphasis on online materials in lieu of personalized, one-on-one, or group sessions. It may be it less expensive to offer online educational help, but this method is not getting through to participants the way personal education sessions do.

The design and direction of 401(k) plans are going through a dramatic change. The emphasis today is on easing workers into a position where they can gain optimal benefits from their plans by eschewing choice and having virtually all decisions made automatically for them.

That shift in direction is significant, because the initial concept behind 401(k) plans was to give workers—rather than their employers—the responsibility for saving for their retirements. The industry has taken 25 years to learn that too many workers do not want that responsibility and are slipping off the precipice when it comes to building up assets for their retirements.

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## **ClearPoint Financial**

Paul Grutzner

Daphne Smith • Jackie Ott

Gary Giffen • Jim McDonald

Peter Carpenter • Kevin Overbey

Kerr Bacchus

720 Olive Way, Suite 1700

Seattle, WA 98101

(206) 962-2000

Boston (617) 965-1795

Minneapolis (612) 373-7040