Retirement Ready— or Not?

BY JUDY WARD

How plan advisors are helping plan sponsors focus on retirement outcomes

"W

here do you think your employees are going to get the money to stop working?"

That's the simple, and yet very complex, question that advisor Peter Philipp likes to ask sponsors to start a conversation about retirement outcomes.

Sponsors usually respond that they think that money will come from a combination of Social Security and their participants' 401(k) accounts, says Philipp, a financial advisor at Newport Advisory in San Francisco. "Then it is a natural question to ask them, 'How much of participants' income in retirement do you think should come from the 401(k) plan?'"

That starts a broader discussion about the income-replacement ratio needed to retire comfortably, the likelihood that a plan's retiring participants will achieve it — and if many won't, how much the sponsor can and wants to do to change that. Most employers need an advisor's help gaining clarity on how responsible they feel for participants' end results, Philipp thinks. "They may not have even given this any thought," he says. "It's incumbent on us as 401(k) advisors to help them articulate that."

Asked in a 2014 poll by Wells Fargo Institutional Retirement and Trust of its recordkeeping clients about the goal of their workplace retirement plan, 54% of sponsors identified it as ensuring that employees have a secure retirement, 38% characterized it as a supplement to other forms of retirement savings, and just 8% saw their plan's purpose as providing a benefit to compete against company peers.

"Some sponsors are just starting to think about outcomes, since in the past they thought they needed a retirement plan because that's part of what it takes to attract employees," says Gregory Kasten, chief executive officer of Unified Trust Co., NA in Lexington, Ky. "But they had never thought about, 'Is the plan supposed to do something? And if it is supposed to do something, what is it supposed to do?'"

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What's the Point?

As director of Wells Fargo Institutional Retirement and Trust, Joe Ready often has the chance to sit down and talk with plan committees. "One of my favorite things I like to do to start off the conversation — to get to a more strategic dialogue — is ask them, 'Your retirement plan that you offer: What's the point?'" says the Charlotte, N.C.-based Ready. "For example, a committee needs to decide if they view the 401(k) as a supplement or primary retirement benefit for employees." As a sponsor, he says, "You really need to be honest with yourself on that question. Your plan design, your actions, and how you measure the plan's success will be grounded in the answer."

Federal law doesn't explicitly say that sponsors have responsibility for participants' retirement outcomes. "There is no specific directive within ERISA that says plan sponsors have an obligation to make sure that participants are ready for retirement," says Alan Hahn, a partner at law firm Davis & Gilbert LLP in New York City. "But the issue sponsors and advisors are struggling with is, if there is not an express obligation to get participants ready for retirement, is there some implied responsibility?"

Today's employers have a wide range of feelings about their level of responsibility for employees to achieve retirement readiness, says advisor Joe Connell, director of retirement plan services at Sikich Financial in Maple Grove, Minn. "Some are very involved in that process, some are just learning about it, and some feel it is an area that they don't want to be involved in or to measure their plan's success on that," he says. "A lot of employers haven't even thought of why it should matter. [Advisors] should have that discussion with them, to figure out how much emphasis they want to put on it."

When advisor Brian Allen and his colleagues at Pension Consultants, Inc. talk with new plan sponsor clients, they ask right away about a sponsor's philosophy

on its responsibility for outcomes. "We ask them to characterize themselves into one of three buckets," says Allen, president of the Springfield, Mo. advisory firm. The first one he calls "Choice," and characterizes the sponsor mindset as, "We have a philosophy of offering a retirement plan to employees as a choice. If they want to take advantage of it, great. If not, that's their choice."

The second category he calls "Informed," which he describes as: "We feel an obligation to inform employees about the plan and its impact on their retirement readiness," but the employer doesn't feel responsible for retirement outcomes. He calls the third category "Ready" and explains the philosophy as: "We really have a paternalistic philosophy, and our goal is to make sure that our employees are ready for retirement."

An advisor also can help an employer gain clarity on its philosophy by seeing the larger factors at work. "It's partly a matter of where the company is in the different stages of the business cycle," says advisor Carmela Elco, managing director at Blue Prairie Group in King of Prussia, Penn. Startups tend to have different priorities than mature businesses, and those priorities often shift over time. "The word 'evolution' is important. It's always changing," she says. "You always have to look at the big picture, and understand in what direction they're going."

How responsible an employer feels also depends on the industry and the importance of other benefits to employees, Connell says. In some industries, for instance, employees may value their medical benefits the most, so an employer might choose to provide very good health care coverage, and offer a discretionary 401(k) match. The retirement plan's goals "have to be looked at in the context of the whole benefits package," he says.

At the same time, advisors can help employers thinking about their responsibility see the bigger picture on the potential consequences for them if employees don't save enough for retirement.

Ready often talks with sponsors about mounting evidence that many American workers will not be able to retire at age 65. According to the 2014 "Wells Fargo Middle-Class Retirement" study, 33% of middle-class Americans say they will need to work until at least age 80 because they will not have enough retirement savings — and that percentage jumps to half for those in their 50s. "You should know that the evidence is starting to suggest that many people will not leave the workforce at a normal retirement age, given that many will not be ready financially, and you need to factor that into your forecasts of your future expenses," Ready tells employers. Particularly when he's talking with CFOs, he adds, "That starts to connect the dots for them as to why overall employee retirement readiness is an important plan measure."

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Philipp also finds that reality check effective. "We don't start here, but ultimately we wind up with this idea of, 'Well, what's going to happen to your employees who aren't ready for retirement? They're going to keep working, and they probably will keep working for you,'" he says. "That has plusses and minuses. You get to retain that knowledge, but an aging workforce may increase an employer's health care expenses."

Beyond the workforce-planning implications, Kasten raises the additional possibility of future participant lawsuits over sponsor responsibility for outcomes. "I don't believe that the courts will ever mandate something like, 'Everybody in a retirement plan is supposed to be able to replace 70% of their income,'" he says. "But I do believe that the courts will slowly move toward the new frontier of, 'Do you have in place a plan that has a reasonably good chance of providing an adequate benefit to your participants?'" So an employer that implemented auto enrollment at 3% with no escalation could be vulnerable, he thinks, since that has virtually no change of producing adequate savings. "Maybe it's not a 'bright line of success' test that will emerge, it's a 'bright line of failure' test," he says.

Hahn doesn't see a big risk of sponsors losing future lawsuits over participant outcomes on the basis of plan design, if the sponsor is otherwise doing its job. In terms of the possible "implied responsibility" for outcomes in ERISA, the overarching issue is whether sponsors did enough to explain both the plan and their individual retirement savings outlook to help employees make the right choices, he says. On the macro level, that means explaining to employees "how the plan is meant to get them from point A to point B," he says. On the micro level, it means giving participants projections of what they might need in retirement, and what they're on track to actually have. "It comes back to what the plan design really means on an individual level," he says.

Defining Success

Once sponsors have defined their priorities, they should figure out how that translates into defining plan success. For sponsors focused on offering a competitive plan that helps them hire and keep the employees they want, Ready says, "then that committee's time may be spent on asking, 'Do we have good investments, and are they cost-effective?' The committee may spend 75% of its time on that."

For a sponsor that wants to focus more on participant outcomes, Connell suggests that an advisor can start to help by getting data from that plan's recordkeeper to do an analysis of the plan's health. "We look at all the data and pare

PLAN SPONSORS, ADVISORS DIFFER ON PLAN SUCCESS MEASURES — NEVIN E. ADAMS, JD

You hear a lot of talk these days about measuring plan health, retirement readiness and plan outcomes.

Realizing that each plan can have its own measure of success, in early April, NAPA Net readers were how their plan sponsor clients measure plan success — and how that compares with the measure(s) they use.

Participation, Rated

Nearly 4 in 10 (37%) respondents said that participation rate was the measure of success for their plan sponsor clients. However, the second-most cited response was projected retirement income replacement rate(s) — though it was cited by only 17%.

The deferral rate of various demographics (highly compensated versus non-highly compensated) was third-most cited, at 12%, and projected monthly retirement income was fourth (8%). Finally, participants saving to the level of the match, plan design feature benchmarking and — well, no particular method of measurement rounded out the responses.

Income Oriented?

The picture was quite different from the advisor perspective. The most cited measure used by survey respondents was projected retirement income replacement rates, cited by nearly 42%, and the second-most cited response (21%) was projected monthly retirement income. As one advisor noted, "anything that gets measured can be improved, so I love to see plans at least measuring something, but in my experience the replacement of income at retirement is the best way to improve the entire country."

Plan design feature benchmarking (12%) rounded out the top three, with participation rate, deferral rates of various demographics, increase in deferral rates and plan design feature benchmarking rounding out the responses.

Measures Measured

Nearly 55% of respondents said their recommended measure had changed over the past five years; just under 17% said it hadn't. Among those had shifted, the move had clearly been toward projected retirement income, and that shift was clearly enabled by the advent of new technologies. One advisor explained, "Our measure has migrated from simple plan participation, average and median contribution rates to projected monthly income. This migration is due primarily to our increased use of available technology to "crunch the numbers" on income replacement." Another said, "Technology has allowed us to shift to measuring success for plans by way of determining who is fully funded versus the underfunded group and then measure progress. Five years ago, we were just beginning to do this work, today it is a primary deliverable."

Other respondent insights:

- "Every plan has its own metrics, making it difficult/impossible to use a check-box approach. I look for the weak spots in each plan, and solve for that; success for one plan may be completely different for another."
- "In the past, there was so much focus by employers to compare fund performance and fees to determine if they had a 'good plan.' But a cheap lineup of high performing funds won't help if employees aren't utilizing the plans."
- "Plan utilization needs to be addressed. Above and beyond participation, we need to think about how plan sponsors can utilize all the provisions in a qualified plan to promote and provide retirement readiness for their employees."

One reader summed it up like this: "I find it interesting that most of the market discusses retirement readiness, but still places a lot of the responsibility on the sponsor or participants to actively participate when it has been demonstrated time and again that clients need to have as much done for them as possible. Will be interesting to see if the market will adapt accordingly or, in five years will it still be about investments (nothing really ever changes)."

it down for the sponsor to a useful three to five statistics that particularly help drive the participant outcome," he says. Four data points often make for a good focus for sponsors to try to improve: the participation rate, deferral rates, investment diversification, and most importantly, projected income replacement ratios. He adds that advisors should not just do a plan-level retirement readiness estimate, but also do projections for different demographic groups, such as participants age 45 and older.

For outcomes-focused sponsors, advisor Vincent Morris says that Bukaty Companies Financial Services does a two-part customized analysis. First it estimates the average replacement ratio that a plan's participants will need in retirement, says Morris, the Leawood, Kan.-based president of Bukaty. That calculation includes factors such as projected future wage increases, a demographic analysis of the workforce, and projections of future inflation rates and market returns. "Second, we look at the population as a whole and do an analysis of, how many people are projected to cross that line?"

Unified Trust works with sponsors to put together a plan's "benefit policy statement," which Kasten calls a sister document to the investment policy statement, that spells out what outcomes a sponsor wants its plan to achieve. "If you want to manage outcomes, you are going to have to measure outcomes — and go a step further and define the outcomes you want," he says.

Helping sponsors focus more on optimizing participant results does have its challenges. Plan committee members sometimes feel reluctant to document a specific goal for 401(k) participant outcomes, Philipp says. "They wonder, 'Should we as an employer be taking the lead in that? We come back with, 'Well, who should be taking the lead?'"

Documenting retirement outcome goals at the fiduciary level likely doesn't pose a big legal risk for sponsors, Hahn says. "The way that ERISA looks at satisfying fiduciary obligations is that it's largely an issue of employing a process in making decisions, and documenting that process," he says. "Rarely is there a case when documenting

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something gets you in more trouble. You probably have a greater exposure in not documenting it."

Employers' financial constraints present another challenge. "There is also the dollars-and-cents aspect of it," Morris says. Some employers presented with the chance to improve outcomes by taking a step such as increasing their match may say, "We just can't afford to do that," he says. Many business considerations go into how responsible an employer feels for getting employees ready for retirement, Allen says. As advisors working in areas such as participant education, he adds, "Our job is to give them the best results we can for the commitment the employer can make."

When talking to sponsors about how to optimize their plan for participant outcomes, Elco finds they rarely if ever can implement every step in one fell swoop. "It's usually step by step," she says. "It's a matter of helping them work within the parameters of what they can actually accomplish at any given time. You can't just say, 'Let's give them all a 100% replacement ratio.'"

» Judy Ward is a freelance writer who specializes in covering retirement plans.

HOW DO PLAN SPONSORS MEASURE SUCCESS?

When plan sponsors were asked how they felt their organizations did on several key plan success measures, overall participation rate ranked highest, and was most commonly measured. Participant outcomes did not fare so well.

Regarding overall participation rates as a measure, 18% of plan sponsors said they did an excellent job with it; 38% felt they did a "very good job" and 31% a "good job." Just 4% felt they did a poor job here, and 8% a "fair" job. Nearly all (83%) of respondents formally measured overall participation rate.

On the other hand, only about a quarter (28%) of the 310 plan sponsor respondents to the survey of plan sponsors by American Century formally measure how ready employees are for retirement. Still, one-in-twenty feel they are doing an excellent job here, 17% a very good job, and nearly one-in-four (39%) a good job. Just 7% say they are doing a poor job, but one-in-ten admit they don't know.

Success Measures

Nor do plan sponsors appear to be concerned about their accountability for those participant outcomes. Asked about their level of concern that employees might sue if they don't achieve the results they feel they should, nearly two-thirds (63%) said they were "not concerned." Only 7% were "very concerned," and 27% were "somewhat concerned."

Among the other measures of plan success:

- 81% formally measured the percent of eligible employees taking full advantage of the match; 19% thought they did an excellent job in that area, 34% a very good job, and 31% a good job. Fewer than 3% think they do a poor job here.
- 72% formally measure the general contribution rate. However, only 11% think they do an excellent job here, while 35% claim to do a very good job, and 38% say a good job. Again, fewer than 3% think they do a poor job here.
- 68% track the participation rate of NHCEs, with 16% saying they do an excellent job here and 31% a good job; slightly more (32%) say their execution level is good. Poor performance here was admitted by just 4%.
- 61% monitor the percent of employees who contribute the maximum, with 9% saying they do an excellent job with this, 28% a very good job, and 35% a good job. Six percent say they do a poor job in this area.

Goals Oriented?

Somewhat ironically in view of the success measures, when the plan sponsors were asked to rank the importance of several corporate goals associated with offering a retirement plan, "supporting employees' efforts to have a secure retirement" topped the list, cited as being "extremely important" by 62% of respondents (and 30% as "very important"), just outpacing the 54% who opted for the traditional "attracting and retaining workers" (and 38% who said that was "very important").

As for assessing the success of their retirement plan, 38% cited as "extremely important" the percentage of employees taking full advantage of the match, just ahead of the 37% who cited "the overall participation rate." Both categories also ranked highly (19% and 18%, respectively) on the factors that plan sponsors said they felt their company does well in achieving, given their industry and employee population.

As for other success factors, roughly a third (32%) said that the participation rate of non-highly compensated workers was "extremely important," while 30% cited employees' self-reported satisfaction with the plan.

Just 28% said that how ready employees are for retirement is "extremely important" (though another 47% said that factor was "very important." The general contribution rate (24%) and percent of employees who contribute the maximum (17%) were also on the "extremely important" list.

A total of 310 plan sponsors were surveyed, representing plan assets of less than $25 million to $100 million.