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THE OFFICIAL MAGAZINE OF THE NATIONAL ASSOCIATION OF PLAN ADVISORS

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DIFFERENCES THAT COULD IMPACT THEIR
VOLATILITY IN THE NEXT BIG DOWNTURN.

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Making the shift to 403(b)**

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Wishful Thinking?

8 retirement plan holiday “wishes”



One of my favorite memories growing up was paging through Christmas catalogues – my favorite the “Wish Book,” it was called – and going through it looking for the things that I hoped Santa, and then later, my parents, would bring. After struggling for possession of the catalogue, my brother and I would turn down the corner of the pages on which those items could be found. That also made it easier as Christmas approached, to revisit, and occasionally reconsider, those “wishes.”

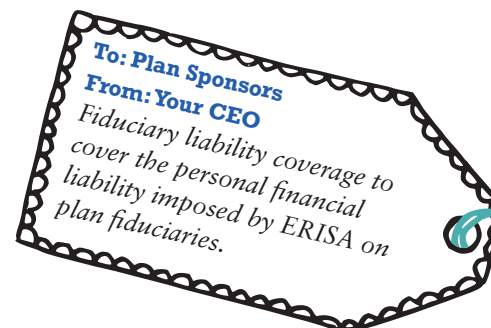
Of course, these days those “wish lists” are online – a lifesaver for every grandparent, parent and distant relation who wants to give something more “thoughtful” than a mere gift card, but has no sense of what you want, much less have.

Here are some “gifts” that we might all wish to find waiting for us in 2020. **N**



Neve

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Leaders All Around Us

We have put our profession on the map as leaders in an industry that needed moral leadership.



BY JANIA STOUT



In the last issue of *NAPA Net the Magazine*, I wrote in this space about the “Butterfly Effect” and how I truly feel that it is our industry and our awesome plan advisors that kicked off the idea of collapsing the silos around the health and wealth discussions.

We have been forward thinkers about financial wellness, and now we see the results in the new products and services that are being launched almost on a weekly basis. I see the impact we are making on this front, even in other industries – so kudos to us!

I am writing this column on Veteran’s Day and I can’t help but think about the word leadership. Last month, the NAPA

Leadership Council held our two-day meeting in Annapolis, MD. Part of the agenda was a walking “Leadership Tour” at the United States Naval Academy. We were led by Daniel Morris, a retired Navy officer, who spoke about some historical events and the leadership lessons in each of them. It was a moving experience.

One thing that struck me while listening to him speak was that we are all leaders, even in our own small world. We might lead a team, we might lead a client meeting, or we might lead an industry – but all of us will be called upon at some point in our careers to be a leader.

Morris shared a quotation with us from John A. Lejuene, the Marine Corps’ 13th

Commandant, who served in the Marines for nearly 40 years and commanded the U.S. Army’s 2nd Division during World War I:

Leadership is the sum of those qualities of intellect, human understanding, and moral character that enables a person to inspire and control a group of people successfully.

To me these words are quite powerful. I believe they can be applied to what we are doing when we help plan sponsors design good retirement programs and at the same time inspire working Americans to do better – in their financial picture as well as their overall wellness.

As we close out the remainder of 2019, I think we can all look back at the milestones we have achieved with a smile. What a year it has been – kicking off in April with the NAPA 401(k) Summit, where thousands of advisors gathered to learn ways to impact outcomes for our plan sponsors and plan participants.

I have to chuckle to myself at times when I think back to when the Pension Protection Act was passed, and plan sponsors started to adopt automatic enrollment. There may have been some at the time who thought we had figured out how to fix some of the problems of participation. Lo and behold, however, we soon realized there was more work to do – and many of you stepped up to meet that challenge, and became leaders by doing even more.

We have put our profession on the map as leaders in an industry that needed moral leadership. I can’t wait to see what we do in 2020! I also hope to see some of the wonderful women in our industry at January’s Women in Retirement Conference (WiRC) in New Orleans. It is going to be epic! **N**

» Jania Stout is the co-founder and managing director of Fiduciary Plan Advisors at HighTower in Owings Mills, MD. She serves as NAPA’s 2019-2020 President.



CONFERENCE SCHEDULE

napa-net.org/events

Upcoming 2020 Events

JAN
15-17

WOMEN IN RETIREMENT CONFERENCE

New Orleans, LA

APR
26-28

NAPA 401(k) SUMMIT

Orlando, FL

JUL
19-20

APEX ROUNDTABLE

Washington, DC

JUL
21-22

NAPA D.C. FLY-IN FORUM

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SEPT
24-26

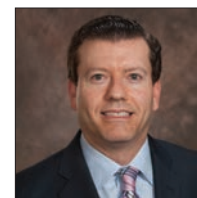
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Washington, DC



BY BRIAN H. GRAFF

An Open Mind About Open MEPs

In a time in which there seems to be little bipartisan support for anything on Capitol Hill, Multiple Employer Plans stand out.

Ironically, one of the most popular provisions in the SECURE Act also turns out to be one of the most controversial among industry professionals.

Specifically, that's the proposal regarding "opening" multiple employer plans, or MEPs. Called Pooled Employer Plans (PEPs) in the current legislative package, proponents have long maintained that the opening of this construct to any adopting employer would help close the current coverage gap, provide a more efficient means for more employers to offer a retirement plan (which would help close the coverage gap), provide additional ways for providers to (more profitably) serve that market (and thus to help close the coverage gap).

It's why the American Retirement Association has – with some important conditions – supported the concept. Our recent comment letter to the Labor Department noted that these "open" MEPs "hold the potential to increase efficiencies, manage costs more effectively, reduce burdens on employers, and improve retirement outcomes for the American workforce," and that "...extending the availability of MEPs is a positive development in expanding retirement plan coverage for working Americans."

However, while it is our belief that open MEPs could have a positive impact on closing the retirement plan coverage gap, it also has the potential to be a negative disruption for the current business models of many in our industry, notably TPAs and plan auditors, for whom the effective

consolidation of multiple ERISA plans into one¹ could well diminish current revenue flows, as it reduces the number of individual plans to which they provide that support. And while it offers the potential to more effectively serve smaller plans, retirement plan advisors too see the potential for disintermediation of their business by the aggregation of current plans into a MEP-3(16) construct.

In a time in which there seems to be little bipartisan support for anything on Capitol Hill, MEPs stand out. There is, and has been, strong support on both sides of the aisle for the concept. The opportunities afforded by the design were acknowledged in President Trump's 2018 admonition to the Labor Department to consider changes to the current boundaries, and that ultimately resulted in new regulations expanding Association Retirement Plans.

As you might expect, over the years (open MEPs are not exactly a new idea) we've had hours and hours of discussions with our members, plan sponsors, providers, advisors, as well as with regulators and legislators, to craft the best possible application of the open MEP concept to help expand workplace retirement plan access to the millions of working Americans who have now gone a generation without that opportunity. We've done that with both a sensitivity to the need for those solutions, as well as the potential disruption to the valuable support provided by our members.

We've fought for – and won – the retention of a fiduciary involvement by

the plan sponsor in the selection and monitoring of the MEP provider, and we've continued to press for the Labor Department's oversight role with regard to MEP providers, as well as broad authority to conduct investigations and audits of open MEP service providers to protect plan participants from fraud and abuse.

As we head to press, the fate of the SECURE Act, much less the provisions regarding MEPs/PEPs, remains uncertain, but it seems likely that legislative and regulatory interest in, and support for, the concept will endure. In the macro sense, competition in the marketplace ultimately will determine whether open MEPs are economically viable, and the DOL and the IRS will play a key role in mitigating the costs and complexities with respect to the expansion of open MEPs.

The American Retirement Association remains committed to creative ways to help close the retirement plan coverage gap, sheltered and supported by prudent oversight, fueled by private sector engagement and innovation. And, whatever interim disruptions in product or process may result from the expansion of open MEPs, I am confident that the committed professionals in our industry will not only survive, but thrive as we continue to find new ways to help build America's retirement. **N**

» Brian H. Graff, Esq., APM, is the Executive Director of NAPA and the CEO of the American Retirement Association.

¹ As a MEP, one IRS Form 5500 Annual Report is filed, one ERISA fidelity bond purchased, and a single annual audit by an independent accountant conducted for the entire plan.



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Trends ‘Setting’

Health cost concerns loom large across the demographic spectrum – but a new survey finds those concerns are undermining retirement savings of the young as well. This issue we also report on some new findings about group dynamics that can help you better manage committee meetings, and some real generation gaps in terms of retirement plan preparations and expectations.

HEALTH ‘CARES’

Health care worries sidetracking young adults’ retirement planning

Despite concerns over current and future health care costs, many younger adults are not taking advantage of immediate opportunities to help plan for their financial future, a recent survey reveals.

Nationwide Retirement Institute’s “Health Care Costs in Retirement Consumer Survey” finds that health care expenses can impact people so greatly that it has caused them to take “risky” actions to save on health care costs. According to the report, one in five (20%) younger adults report that health care expenses have caused them to:

- skip getting care (48%);
- go into debt (38%);
- stop saving for discretionary purchases (43%);
- not contribute as much as they would like to their 401(k) account (31%); or
- file for bankruptcy (13%).

What’s more, the number one financial concern of younger adults is not having the money to cover unplanned medical expenses.

More than one in four respondents (28%) admit they would not be able to afford a \$7,500 out-of-pocket health expense. And when asked about sources used to cover the cost, nearly one in five (18%) indicated they would tap their 401(k) or similar retirement plan, while 30% indicated they would use a credit card.

Meanwhile, nearly 70% agree that prioritizing self-care and mental health will help them save on future health care expenses and would like to do more to prioritize their health. Yet one in three younger adults admit that health and wellness are not top priorities for them. What’s more, half of younger adult respondents say that 10 to 15 years from now they will wish they had taken better care of their health.

Opportunities Await

“The financial barriers to affording health care can be overwhelming; however, many adults don’t realize there are a number of ways to lessen the financial burden,” says John Carter, president of Nationwide

Retirement Plans and president and chief operating officer-elect of Nationwide Financial. Carter emphasizes that there are tools, employer programs and resources that can help consumers prioritize their health, remove cost barriers and best provide insight into how to address concerns. For example, Carter notes that taking advantage of an HSA, participating in employer programs or working with a financial advisor are relatively low-cost, easy actions consumers can take to help lessen the burden of health care costs in and out of retirement.

Yet, many younger adults are not having informed discussions with professionals on how to prepare. According to the study, only 22% of respondents reported that they had met with a financial advisor. “Health and wealth are highly personal and complex topics, and it’s easy to be overwhelmed when trying to prepare oneself for today and tomorrow,” Carter emphasizes. “Working with an advisor and taking advantage of online tools, in preparation for retirement, can help adults



both young and old reach personal goals and achieve the retirement they envisioned.”

HSA Benefits

One hurdle to overcome with HSAs, however, is that both younger and older adults lack understanding of the advantages they can provide from a tax perspective and as a retirement savings tool. The study found that only 17% of younger adults use an HSA, and of those who have one, 25% use it to pay only for today’s health care expenses (rather than saving those funds as a tax-free way to cover health care costs in retirement).

Additionally, more than half of all people are not aware contributions made to an HSA are tax deductible or that money in an HSA can grow tax deferred. This knowledge gap could be an indicator of why people are not taking advantage

of them, the study observes. “There is a clear opportunity for further education around and greater adoption of HSAs among younger and older adults,” says Kristi Rodriguez, leader of the Nationwide Retirement Institute, in noting that HSAs are an effective tool for supplementing retirement savings, while also offering tax benefits.

And many others agree with this recommendation. Findings from the Plan Sponsor Council of America’s recent survey on HSA design and use show that 60% of plan sponsor respondents agree that employee education remains the dominant concern of plan sponsors.

Nationwide’s findings were gathered from a survey conducted online by Edelman Intelligence from July 9-13, 2019, among 1,000 U.S. adults ages 25 to 45.

— *Ted Godbout*

TEMPERATURE’S RISING?

Retiree health care cost projections on the rise – again

If your clients haven’t started factoring in how much they’ll need to cover health care costs in retirement, a new report might convince them to start doing so.

Annual estimates about the potential cost of retiree health care produced by consulting firm Milliman show that a healthy 65-year-old couple retiring in 2019 is projected to spend \$369,000 in today’s dollars (\$551,000 in future dollars) on health care over their lifetime. In addition, expenses at age 85 are

estimated to be 250% higher than at age 65.

For purposes of this estimate, the firm assumes that the health statuses of the retiree and spouse are assumed to be average for the entire life span of each person. These averages are based on a typical commercially insured population in the Milliman Health Cost Guidelines. The retiree and spouse are assumed to be male and female with lifespans of 87 and 89, respectively. The estimates also assume that the future medical trend will be 4.9% per year, based on long-term estimates from a Society of Actuaries model, supplemented with Milliman research.

Milliman further estimates that a healthy 67-year-old retired couple is projected to spend 39% of their pre-tax Social Security benefit on health care in 2019. This estimate is based partially on the December 2017 average monthly pre-tax Social Security benefit at age 65 to 69 of \$1,388.38 for retirees and \$817.99 for spouses is used, with adjustments to 2019.

The projected retiree health care costs for a healthy 45-year-old couple who retires at age 65 is projected to pay \$532,000 in 2019 dollars, and \$1.4 million over their retirement years.

Meanwhile, the estimated 2019 annual premium plus out-of-pocket cost for a healthy 65-year-old is \$5,000. This estimate assumes the health status of the retiree is to be average, based on a typical commercially insured population based in the Milliman Health Cost Guidelines. It also assumes the 2019 nationwide average premiums and out-of-pocket expenses at age 65 for a Medicare Supplement Plan G and a standard Medicare Part D plan are used.

Milliman does offer a word of caution that the projection of retiree health care costs is a “complicated exercise” and actual results will vary from projections. The firm also notes that laws, regulations and rules governing health plans in the U.S., market forces, changes in health status and external shocks can also have a material effect on retiree health care costs.

Nevertheless, while recent estimates by Fidelity come in slightly lower, both studies appear to lend credence that retiree health care costs remain a top concern of both pre- and existing retirees.

— Ted Godbout

How group dynamics affect plan governance

'GROUP' THINK

Group dynamics exert a powerful influence when a retirement plan committee is making a decision. An industry expert recently offered his take on the consequences of that phenomenon.

At an Oct. 28 session during a two-day meeting of the Plan Sponsor Council of America's Leadership Council, Warren Cormier, CEO of Boston Research Technologies, noted that group dynamics have existed since more than one human came together to make a decision, and discussed how groups work and how to overcome some of the negative consequences of their dynamics.

Group Bias

“It's inevitable that you're going to have group decision bias,” Cormier said. Group bias is one of the ways groups reach suboptimal outcomes, he said, telling attendees, “It not a question of whether there's group bias. It's a question of what kind and how much.”

But there are remedies for group bias, Cormier said:

- have committee members from diverse disciplines;
- control the size of the group;
- have a committee member who can serve as a devil's advocate;
- employ a leadership style that ensures all committee members participate;
- have input from outside experts; and
- frame the questions the committee addresses in a way that encourages participation.

Committee Dynamics

The four most powerful cognitive forces affecting behavior when one is part of a committee, said Cormier, are:

1. Trust
2. Loss aversion
3. Regret aversion
4. Overconfidence

Cormier cited research showing people feel a loss twice as much as they feel success, and he suggested that it can apply to committee dynamics. “Is a committee trying to optimize its decision or minimize its losses?” he asked, remarking that in his experience, “it's often the latter.”

Cormier cited other research that found that when like-minded people speak with one another, they tend to become more extreme, more confident and more unified. “Committees can assume, ‘we all know what we're doing,’” he said.

Cormier identified additional factors that may cause a committee member to modify their position and change their behavior:

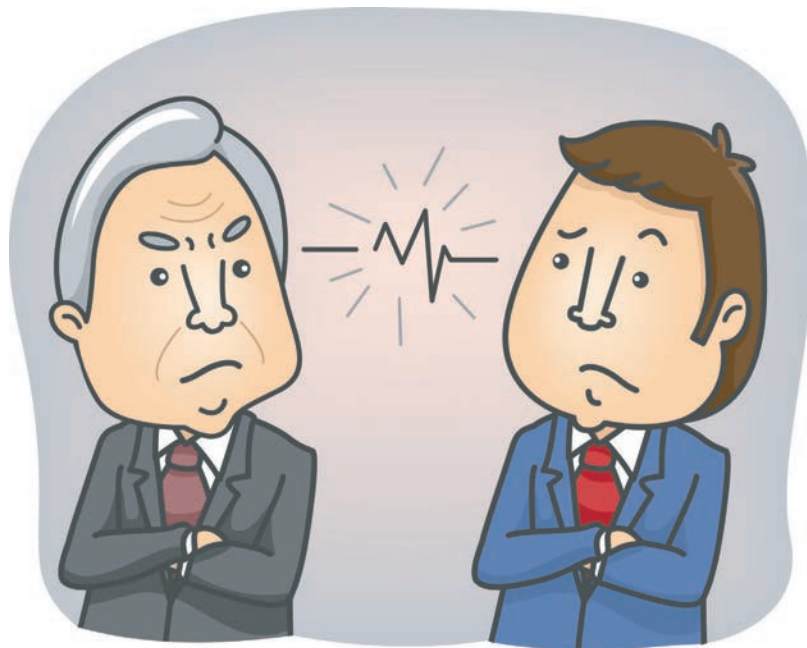
- group harmony discourages dissent;
- people may vote differently if their vote is made public;
- staff members may defer to supervisors' opinions; and
- committee members may defer to experts.

Cormier also observed that people resist being outliers and being a lone voice. But he said that such individuals are exactly who should be on a committee. “You want someone on the committee that is more of a free thinker,” he said.

— John Iekel

GENERATION GRASPS

Stark differences between generations in funding retirement



Most current retirees say they rely primarily on Social Security or a pension to fund their retirement, but a new study finds that younger generations have a different mindset altogether.

More than 8 in 10 (86%) retirees fund their retirement primarily with Social Security or a pension. By contrast, 45% of Millennial workers say the top source of funding for their future retirement will come from a 401(k) or IRA, compared to just 25% who say they expect to rely on Social Security or a pension for their retirement income.

These findings are contained in the 2019 Wells Fargo Retirement study, now in its 10th year, which is based on a survey examining the attitudes and savings of more than 2,700 workers age 18 to 75 and 1,004 retirees.

In fact, there is a fear across all working generations in the survey that Social Security may not be available for retirement, with 71% indicating they are “afraid” it won’t be available when they retire. What’s more, 6 in 10 workers (63%) say they would have no idea what they would do if Social Security were not available “when they need it,” a concern that jumps to 71% for current retirees.

Moreover, the survey found that workers have much more faith in their personal savings than in Social Security. Only 55% of retirees have more faith in personal savings than in Social Security, which compares to 79% of workers.

At the same time, workers recognize that retirement is increasingly their own responsibility – but they believe that public policy can still play a role. Ninety percent say that Congress needs to make it easier for workers to have access to tax-friendly retirement plans and 79% say that companies should automatically enroll new employees in their employer-sponsored retirement plans.

Debt Challenges

The survey also finds that financial challenges are negatively impacting the ability of nearly half of workers to adequately save for retirement, with debt playing a crucial role.

According to the study, 31% of Millennials say they have an “unmanageable amount of debt,” followed by Generation X (26%), Generation Z (25%) and Baby Boomers (14%). Additionally, among all workers, nearly half (46%) say they are putting off saving

for retirement due to current financial challenges and 67% of workers paying student loans say the burden of student loans is getting in the way of saving for retirement.

As a result, Wells Fargo notes that many workers appear to be falling well short of what they will need to fund their retirement. Nearly 30% of respondents have personally saved less than \$25,000; 13% have saved between \$25,000 and \$100,000; and 11% have saved between \$100,000 and \$250,000. Moreover, the study notes that 32% of workers can’t estimate what they have saved for retirement and only 15% of workers have saved \$250,000 or more.

Overall, just over half (55%) of workers say they are saving enough for retirement. By generation, 61% of Baby Boomers say they are saving enough, followed by Millennials (55%), Generation X (51%) and Generation Z (48%).

On the bright side, Wells Fargo emphasizes that younger workers are starting to save much earlier than older generations of workers. Though Baby Boomers started saving around age 36 on average, Generation X started at age 31, Millennials at age 25 and Generation Z at 18, according to the survey.

Planning Mindset

Like the previous year’s findings, current workers with a “planning mindset” start saving at a younger age, save more each month for retirement and have saved more for retirement than workers without the planning mindset, Wells Fargo notes.

Workers with this mindset prioritize saving for retirement after paying monthly expenses (71% versus 53% of those without the planning mindset), say they are in control of or happy about their financial life (82% versus 46%) and are confident they will have enough savings to live comfortably in retirement (80% versus 42%).

The survey was conducted by the Harris Poll on behalf of Wells Fargo from June 21 – July 17, 2019.

— Ted Godbout

FEES ABLE?

DCIO assets resurgent in 2019, but challenges lie ahead

A new report finds “substantial” demand for CITs, alongside a growing interest in fund classes with no revenue sharing.

A new report by Sway Research finds that, asked to rate the demand and need for an array of retirement-specific mutual fund share classes, most asset management firms now feel that shares with 100 and 75 basis point 12b-1 fees are no longer needed, while the need for 50 basis point shares is fading fast. The only share classes that a majority of DCIO executives agree are both needed and making a significant impact on DCIO sales are those with no 12b-1 fee, and the share class with the greatest need and impact on sales also has no revenue sharing (i.e., sub T/A fee).

The report explains that DCIO sales generated via zero-revenue mutual funds (i.e., those that do not pay revenue sharing to distributors from fund fees) spiked this year, as did sales generated via Collective Investment Trusts (which, Sway notes, are “typically” zero-revenue vehicles) – trends that Sway notes are visible across all four of the manager segments (based on DCIO AUM and investment) they analyzed.

CIT ‘Sweet’?

On the CIT front, half of DCIOs surveyed say demand for CITs is growing across plans of all sizes. Sway says it has seen “substantial” demand for CITs in plans with more than \$500 million of assets, but they are seeing the greatest rise in demand for CITs in the \$100M to \$500M segment, according to the report, “The State of DCIO Distribution: 2020—Key Benchmarks, Developing Trends, Winners and Outlook.”

That said, the report cautions that this growth in demand for CITs presents challenges to asset management executives, including educating plan sponsors on those options. Another big challenge: to avoid cannibalizing more profitable mutual fund business. In fact, more than one in five DCIO sales executives surveyed are concerned that offering lower-fee CITs will speed the erosion they are already seeing in profit margins, according to the report.

The report notes that one possible solution to this pressure is to create CITs with minimum investments to ensure the asset manager will receive an ample investment of assets (and revenue) in return for the (generally) lower-fee CITs. It’s an approach already in vogue, apparently; about four in five managers surveyed currently offer CITs with minimum investments, and only about a third of firms surveyed offer CITs with no minimums, according to the report.

AUA Surge

Despite those pressures the report finds that Defined Contribution Investment-Only (DCIO) assets are surging, and those assets under management could grow by 15% this year. The surge comes after a rough end to 2018 – the result of falling stock prices – and, following a rebound in the first half of 2019, are on track to break \$4.4 trillion by the end of 2019, according to Sway. Over the 12-month stretch from mid-year 2018 to mid-year 2019, the average asset manager surveyed by the firm saw its DCIO assets



grow by more than 6%, as 85% of firms experienced a rise in DCIO AUM.

Sway estimates DCIO assets will make up 51% of the total DC market at year-end 2019 and will reach 54% by the end of 2023. The firm’s model shows assets in proprietary recordkeeper products falling to 39% market share this year and 36% in 2023, according to Sway’s latest research study. The report is based on surveys and interviews of DCIO sales leaders and DC plan intermediaries.

On a more subdued note, half the managers surveyed by Sway experienced net redemptions of DCIO assets in the first half of 2019 and in 2018 – an improvement from 2017, when 60% were in net outflows – and the level of net outflows is declining. Managers in Sway’s Tier 1B segment, which manage an average of \$59 billion of DCIO AUM, averaged DCIO net outflows of \$1.4 billion in the first half of 2018, but this shrank to less than \$300 million in the first six months of 2019, according to the report.

At the same time, first-half 2019 DCIO gross sales for the average Tier 1B manager were 53% of the full-year 2018 figure, suggesting these managers are on track for stronger full-year 2019 effort, according to Shay. The report explains that managers have had a lot of challenges to adapt to in recent years, including intense downward pressure on fees and the subsequent rise of passive management, as well as the proliferation of target-date solutions.

In response, firms have made changes to product lines – fee cuts, zero-revenue pricing, collective trusts, etc. – and sales efforts, greater emphasis on retention, enhanced coverage of aggregators and model-builders, investment in sales analytics, and so on. According to Shay, these moves are beginning to pay off.

— Nevin E. Adams, JD

BIAS 'SAYS'

How to help your plan sponsor clients overcome behavioral biases

Being easily influenced by recent news is one of the most common behavioral biases that impact investing decisions, but helping clients overcome such bias remains an ongoing challenge.

That's one finding from the BeFi Barometer 2019 survey of 301 financial advisors. The survey sponsored by Charles Schwab Investment Management (CSIM) and conducted in collaboration with the Investments & Wealth Institute and Cerulli Associates set out to learn how advisors view and use behavioral finance when working with clients.

In the resulting white paper, "The Role of Behavioral Finance in Advising Clients," the firms advise that understanding the various ways behavioral tendencies can impact investors is fundamental to building a successful wealth management practice.

or accepting less risk than they can tolerate): 26%

- Confirmation bias (seeking information that reinforces their perception): 25%
- Familiarity/home bias (preferring to invest in familiar/U.S. domiciled companies): 24%
- Anchoring bias (focusing on a specific reference point when making investment decisions): 24%

Biases by Generation

The survey results also suggest that vulnerability to specific behavioral biases varies by client age. Advisors say they observe that the following biases are most prevalent within each generation:

- Millennials: Framing bias (54%)
- Gen X: Recency bias (64%)

impact of behavioral biases, nearly two-thirds (62%) cite helping clients take a long-term view as a "very effective" strategy. This is true particularly in periods of volatility, reminding clients of their investment goals and ensuring they adhere to a sensible financial plan can help them reduce emotional reactions and avoid making poor investment decisions, according to the study.

Advisors also cite implementing a systematic process (e.g., automatic rebalancing) and a goals-based planning approach as effective strategies to help take the emotional decisionmaking out of the process and reduce the likelihood they will overreact to a drastic market move.

The research also highlights that it is important for advisors to not only understand client biases, but also be cognizant of their own. Advisors ranked loss aversion (29%), overconfidence (17%) and confirmation (9%) as the top three biases that impact their own perspectives and decisionmaking.

Bridging the Gap

Notably, nearly three-quarters (71%) of advisors surveyed say they incorporate behavioral finance principles into their client communications and interactions, while just 58% say they apply the concepts to portfolio construction.

The survey results indicate that advisors are aware of the benefits of incorporating behavioral finance principles into their practices. Nearly half (46%) of respondents indicate that incorporating behavioral finance allowed them to better manage client expectations, while 40% say this gives them the ability to reduce their client's short-term emotional decisions.

Many advisors also say, however, that they lack the resources and tools to bridge the gap between the concept and practical application. Nearly two-thirds (65%) of respondents say the primary reason they don't integrate behavioral finance into their practice is because they have difficulty translating behavioral theory into implementation. ^N

— Ted Godbout

“Nearly two-thirds (65%) of respondents say the primary reason they don't integrate behavioral finance into their practice is because they have difficulty translating behavioral theory into implementation.”

“With the prospect of increased volatility and lower returns on the horizon, advisors who understand the psychological or emotional factors that predispose investors to behavioral biases can differentiate their services in what is becoming an increasingly competitive environment,” explains Omar Aguilar, PhD, Chief Investment Officer of Equities and Multi-Asset Strategies at CSIM.

According to the results, the top five behavioral biases that advisors say significantly affect their clients' investment decisions are:

- Recency bias (being easily influenced by recent news or experiences): 35%
- Loss aversion bias (playing it safe

- Baby Boomers: Anchoring bias (75%)
- Silent Generation: Familiarity/home bias (84%)

Asher Cheses, Research Analyst, High-Net-Worth at Cerulli Associates, notes that recognizing behavioral biases is an important first step. “Advisors who incorporate behavioral finance principles into their practice can help their clients put guardrails in place to avoid irrational decisionmaking and better adhere to a long-term financial plan,” Cheses explains.

Mitigating Behavioral Biases

In asking advisors what the most effective methods are to help clients avoid the

A step-by-step marketing campaign for taking advantage of this new opportunity.

In California, Connecticut, Illinois, Maryland, Massachusetts, New Jersey, New York, Oregon, Vermont and Washington, employers are already subject to a state-facilitated retirement savings plan. And if your state is not on the that list, it's likely that a state-mandated plan is currently being discussed in your state's legislature. Either way, though, this creates an opportunity.

Start with a Targeted List

Form 5500. However, companies subject to state mandated plan requirements will not be found on that list because they don't have a plan.

Search for companies within your area with more than five employees, since most state plans require or will require employers with more than five employees

Identify Opportunities

Think of industries where a state-mandated plan would cause administrative burdens if they were forced into it. One that comes to mind are restaurants. Generally, restaurants have younger employees, high turnover and lower wages. If a restaurant has a state plan, the employer will need to auto-enroll all employees and collect and remit contributions. What if that employee only lasts six weeks? That could be a lot of

administrative time wasted setting up that new hire.

On the other hand, the employer could set up a 401(k) retirement plan with the eligibility of age 21, 1,000 hours of service, semi-annual enrollment dates and an automatic rollover safe harbor. Under this plan design, the employer would save the hassle of immediate enrollment paperwork. It's a great way to insulate the employer, save time and offer a retirement benefit to only those employees with proven longevity.

Use LinkedIn Ads

Did you know that with a budget of \$10 a day, you can run ads on LinkedIn? You can target specific geographic locations and company demographics such as industry types, size and job titles. This means you can reach thousands of plan sponsors each day online! Consider running an ad addressing concerns employers may have about state plans and offer them an opportunity to join your webinar for more info.

Mail Information to Prospects

Send your targeted prospect list a two-page overview that discusses what employers need to know, like deadlines and penalties, and give them their options. Some employers might not realize that they can set up their own plans. Include a call to action to encourage employers to contact you.

Attend and Host Events

Attend networking events and talk about state-sponsored plans (pros and cons). Then ask the attendees what they have for a workplace retirement plan. You might be surprised to learn that some companies with hundreds of employees have never set up a plan.

Then partner with a local TPA and a 360° payroll provider and host a webinar. Promote it on social media and email, then educate employers on the state requirements and the benefits of a 401(k) plan. Talk about such things as eligibility, vesting schedules, creative plan design and employer tax benefits. Most state plans are requiring virtually immediate eligibility, have limited contribution flexibility, and offer no employer tax benefits.

Not all employers are aware of the tax benefits that they can enjoy by setting up their own plan. Keep in mind that all this might be news to them.

Educate Your Centers of Influence

Invite your centers of influence to the webinar presentation. Educate them. There are certain nuances to each state plan; talk about them. For example, in California, even if an employer offers a retirement plan, they still need to register with CalSavers and then certify that they are exempt. If the employer does not do this by the deadline, they could face a penalty of up to \$750 per employee for not complying on a timely basis. Yikes!

Issues for High-Income Earners

Here's another interesting angle to discuss with employers. Did you know that many state-sponsored plans are Roth IRAs? This means that high-income employees or those who are part of high-income households need to continually opt out.

We say continually because most state plans require that all non-participating employees be automatically re-enrolled every two years. So, if the employer has a high-income employee, that person needs to opt out, either through the state retirement website and/or through their employer.

Another consideration is if the employee is part of a high-income household. For example, let's say the employee earns \$50,000 per year; however, the employee's spouse is a doctor and their combined household income is \$300,000 per year. That employee also needs to opt out, because their household income is above the Roth IRA limits.

Find the Reason

For each employer not offering a plan today, there has to be a reason. Find it! Perhaps they believe a plan is too expensive or there will be too much paperwork. Partner with a TPA to set up an appropriate plan design that addresses those barriers. Find out which payroll provider the employer uses and then discuss seamless integration. As you work through these features and benefits, strive to create the best plan for that specific business.

Keep repeating this strategy, especially as it gets closer to your state's required

“Not all employers are aware of the tax benefits that they can enjoy by setting up their own plan.”

establishment deadline. This information will become very relevant as the deadline approaches. Be the advisory firm they think of when they need help.

Don't Undervalue Yourself

One last thing: Don't do it for free. As a startup plan, there will be zero dollars in it. Apply a set-up fee and get paid for your time. If the employer has 150 employees and they've never established a plan, it's not for lack of resources (it's for another reason). Don't feel obligated to discount your services because it's the way business has historically been done. Your time is valuable. They are a legit business and are used to paying professionals for their experience, advice and consulting.

Keep in mind that just because it's a startup plan today doesn't mean that it can't be the beginning of a billion-dollar plan tomorrow.

Thanks for reading and Happy Marketing! N

» Rebecca Hourihan, AIF, PPC, is the founder and CMO of 401(k) Marketing, which she founded to assist qualified experts operate a professional business with professional marketing materials and ongoing awareness campaigns.



What Will Work on Social Media in 2020?

Featuring practical tips from three experts in the industry.

BY SPENCER X SMITH

When I was still wholesaling 401(k) plans in 2013, I was on an advisory board tasked with helping to devise our company's social media strategy.

We bought a software system that allowed our field sales reps to push a button and share company-approved social media content. Back then, that was the “safe” way to incorporate social media into our sales process, and it was frankly the only way we could actually use social media to share content. This option was definitely better than nothing at all. For those of us in

business development, we all know that the “fortune is in the follow-up” – when people think about you more often than not, you get more shots to win business.

Today, financial services entities allow their registered reps and company staff to do much, much more than just push a button. Many of us are permitted to use social media in ways that are both personalized and specific to our business objectives. For this column, I interviewed three such who use social media to drive their marketing and business development goals.

“In 2020, your clients and prospective clients will use social media more and more, and if you’re not showing up in some capacity, you’re going to miss opportunities to win business.”

**Kate Barton, Marketing Manager
at Clearview Advisory**

“In our strategy for social media, we use LinkedIn as a way to stay in touch with people we’ve met or want to work with,” says Barton. “We incorporate it into our drip marketing campaign. We work with small to mid-sized businesses, and some may not have worked with an advisor before. They can be hesitant to sign on the dotted line, and we recognize it takes a while to gain their trust. It’s a big decision to hire an advisor!”

She adds, “LinkedIn and social media allow us to interact with people on a neutral platform and build a relationship over time. We use our own photos and original content almost exclusively, and we hire a photographer every couple of years to take fresh photos.”

To highlight two of Barton’s key points:

- As she said, LinkedIn and social media can be considered “neutral” platforms. In addition to the direct one-on-one follow-up in which we all participate, social media allows us to stay in front of people in an indirect manner. More exposure for you = more people thinking about you = more opportunities.
- Using their own photos allows Barton and her firm to distinguish themselves from similar firms. I call this “anti-stock” photography. Instead of featuring nameless people on your website, brochures, and social media posts, highlight the people who actually work there. The main thing that differentiates your company from others? Your people. Make sure you show the public you’re real people.

Derek Notman, CFP

“I leverage social media by creating a series of short videos that build upon each

other to tell a story and take viewers on a journey, which ultimately led to my website which offered even more value, (e.g., a webinar and eBook),” Notman says. “I also made it a point to create a lot more original content that wasn’t about selling anything but focused on the benefits and outcomes of my services. Both of these led to exponential growth and sales.”

He adds: “A strategy I would recommend using: create short, personalized videos to send as direct messages and via email. My response rate was drastically higher, and I also receive a lot of positive feedback about how personal and different my approach is.”

Notman does a great job here of highlighting the power of video. Fifteen years ago, YouTube didn’t exist, and even if you were lucky enough to have good-quality video to share, how would you have shared it? Today your website and social media accounts allow you to distribute video for free, and what better way is there to have people “experience” what you’re like in real life? So consider adding video to your marketing mix in 2020 if you haven’t already.

Alyssa Rock, Bolder B2B Marketing

“I partner directly with our top sales executives and internal thought leaders who have the best LinkedIn networks (clients and prospects) and provide the correct content, hashtags, and even emojis for them to post on their profiles,” Rock says. “I prefer using their personal pages instead of LinkedIn company social media pages/showcase pages.”

The point of social media “is to be social and spark engagement,” Rock points out. “We convert leads faster when the content is shared on the personal profiles of those with boots on the ground. I leverage these tactics heavily around trade shows

and webinars and consistently outperform any paid placement.”

She hits the nail on the head. You’ll never meet someone who loves LinkedIn company pages and the ability to hyper-focus on targeted prospects with LinkedIn ads than Yours Truly. However, as much as we all love our company’s brand, our clients and prospective clients prefer connecting with individuals – like you.

Is what Rock suggests scalable? Nope. And that’s the point. Personal touches (i.e., the thing that best drives business and engenders trust) outperforms robo-messaging, and it will continue to do so. Rock acts as an accountability partner of sorts for her executives. They know they need to participate in the content creation process, but not take on that burden entirely themselves.

In 2020, your clients and prospective clients will use social media more and more, and if you’re not showing up in some capacity, you’re going to miss opportunities to win business. Here’s my top suggestion for implementing a strategy that will take hold and stick: First create a “not doing” list and write all the tactics down that you’re knowingly not implementing. Not on Twitter? Great! Give yourself credit for something you’re not doing. Instagram? Is that a thing these days? Nope, not using it.

Once you create a long, long list of what you’re not doing, list three things you’ll actually do in 2020 – like weekly LinkedIn posts, monthly videos or a one-time photo shoot, for example. Then revisit your list of “not doing” items, feel great about them, and focus on the activities that drive results. **N**

» Spencer X Smith is the founder of spencerXsmith.com. He’s a former 401(k) wholesaler, and now teaches financial services professionals how to use social media for business development. He may be reached at spencerXsmith.com.





Non-Profit Able

Six ways you
can make a
difference
for 403(b) plans
and their
participants.

By Judy Ward

Ellen Lander

has worked with 403(b) plans for more than a decade, ever since a hedge fund manager client who also sat on the board of a nonprofit asked her to help improve the organization's 403(b) plan. Nonprofit plans now make up 40% of her client base, and she's both gratified and consistently challenged by that work.

"These 403(b) plans have been so misunderstood and so unloved for a long time," says Lander, founder of New York-based Renaissance Benefit Advisors Group, LLC. That includes by many plan advisors, she thinks. "Most of the retirement world is corporate, and then you've got this 'little niche' of nonprofit plans," she says. Ironically, these not-so-little plans have been around about 25 years longer than 401(k) plans, she says, and have issues ranging from expensive legacy investments to a tradition of ongoing one-on-one participant contact that's hard for an advisor to handle cost effectively.

"If you want to be in the not-for-profit space, you need to first understand their culture and the terminology nonprofits use, a nonprofit client's business strategies, and the legacy issues that 403(b) plans have," Lander says. "You're not going to help if

you don't understand those things, you'll hurt. So make sure you know what you're talking about."

Of course, 403(b) plans – a retirement plan that is maintained for employees of certain governmental employers (such as hospitals and public schools), churches, and 501(c)(3) tax-exempt organizations – cover a wide gamut of employer types and diverse employee populations, often defying the relatively simplistic design characterizations of their 401(k) cousins. Consider the fee-focused participant lawsuits filed against multi-billion-dollar university plans, versus recent reports that the SEC is investigating compensation and sales practices in defined contribution plans for K-12 school districts. On the other hand, that scrutiny provides retirement plan specialist advisors an opportunity to help 403(b) plans implement a range of best practices.

"The folks you're working with at these plans, whether they're in HR or finance, don't usually have a lot of experience with overseeing retirement plans. And they are also typically wearing many, many other hats in their job," says Brian Bartkus, Boston-based supervisory principal and managing consultant at Marsh & McLennan Agency. "So they tend to rely on their advisor more than a 401(k) sponsor, and that's both good and bad. It's bad because you do spend more time on them, but it's good because they do put their faith in you. This business is 'sticky': I have 403(b) clients I've worked with for 15 or 20 years. It's because there is a level of trust they have with me, a level of comfort."



Ellen Lander
Renaissance Benefit Advisors Group, LLC

For 401(k) advisors looking to branch out into 403(b) work, five veteran advisors talked about six ways that advisors can help these plans:

1. Governance Best Practices

Earle Allen has worked with 403(b) plans for 29 years, and he's seen their issues change dramatically. "Back when I started, it was getting people enrolled in the plan, communicating with them, and compliance – the administrative details," says Allen, a New York-based partner at Cammack Retirement Group, Inc. "Now, there is a much heavier focus on plan committees and governance. There's been an effort to bring 403(b) plan governance more into alignment with 401(k) plans."

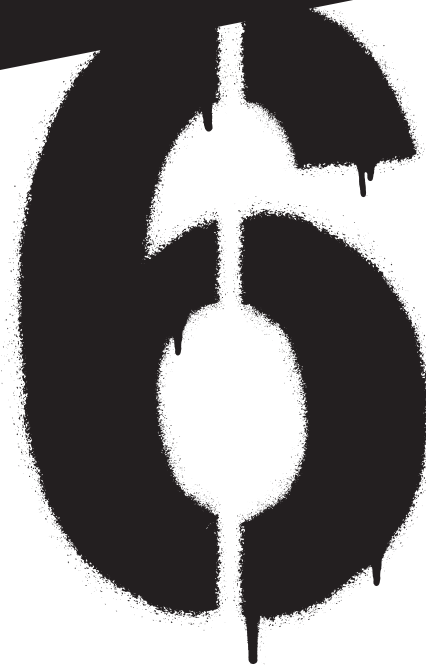
Plan advisors can help a 403(b) committee start using governance best practices, Allen says. That begins with making sure the sponsor has an updated plan document, and an alignment of what the investment policy statement (IPS) says and how the committee actually selects and monitors investments. He also works with 403(b) committees to put together a charter that spells out how a committee will operate. "Help them define, 'Why do we exist as a committee? And who should be part of this committee?'" he suggests. "A lot of attention now is focused on getting the right people on the committee."

Barry Schmitt does a lot of work with university 403(b) plans, and he says their committees have a decision-making process and a culture that can be different than "typical" corporate 401(k) committees. "They often use the term 'shared governance,'" says Schmitt, senior

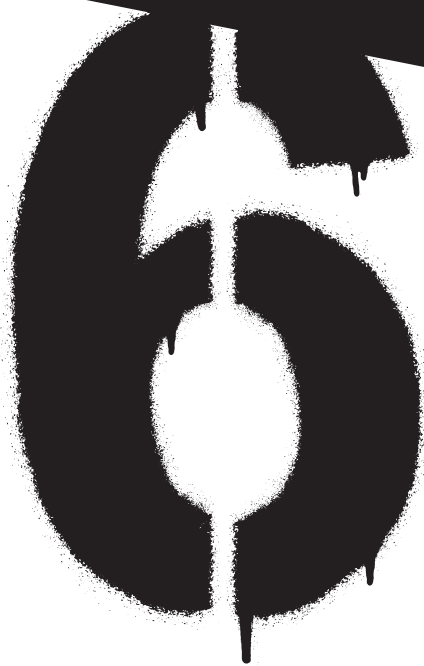
vice president at CAPTRUST in Richmond, Virginia. Before making significant decisions, often these clients solicit input from a wide variety of people across their campus. "As a result, their decision processes can be prolonged, in the sense that they want to make sure that they cover all their bases," he says. "They want to make sure that all the constituencies are on board."

2. Aligning with the Organization's Mission

David Hinderstein got his start in the retirement plan business in 1986 by working with 403(b) plans, and he still works with them today. These plans have fundamental priorities in common with corporate 401(k) plans, he says: The sponsors want to manage their fiduciary



Brian Bartkus, Marsh & McLennan Agency



risk, help their participants retire with dignity, and manage the compliance/regulatory environment.

But 403(b) sponsors are less likely than 401(k) sponsors to have thought through how to align their plan with their organization's overall strategies and goals, says Hinderstein, president of White Plains, New York-based Strategic Retirement Group, Inc. (SRG). "Traditionally they haven't had those conversations, and now they are," he says. "It's newer to them, so we spend time with them, developing strategy. We'll talk about the plan statistics, but then we quickly want to elevate the conversation to, 'How does this compare to your organization's overall strategy?' We've found that not-for-profit plan sponsors – whether it is an independent school or a liberal arts college or a religious organization – all want to have the conversation on how to match their organization's strategy to their total rewards and human capital goals."

Take the time to understand the philosophy and culture of a 403(b) client's organization at the outset, Allen suggests, because it differs from 401(k) clients. "The major underlying difference is that most 403(b) sponsors are part of mission-driven organizations: They are focused on missions like healing the sick or educating the young," he says. "There's a distinct culture at these organizations, and understanding that gives you a better sense of how to align the plan with that philosophy."

3. An Institutional Fund Menu

Lander recalls the days when nonprofit employers would allow insurance agents and other salespeople to set up tables in their employee cafeteria, invite employees to come, and let the salespeople sell 403(b) investments to employees individually. "The 401(k) world has always been institutional, and 403(b)s were more individual retail sales," she says. "Many of these employers

would simply open up the door, and whoever wanted to sell something to their employees on an individual basis could come in the door. So you had a lot of 403(b) participants with extremely high-priced investment products that also had large back-end loads."

Allen also remembers the first-generation 403(b) investments, structured as individual contracts between an employee and the recordkeeper. "The employer was just a conduit," he says. "Then 401(k) plans came into existence, and their investments were all group contracts." That started a gradual migration of 403(b) plans to an institutional menu, which continues today. "There are still billions of dollars of 403(b) assets in individual contracts. So it can be hard to get a reasonable offer from an outside provider, because the outside provider is not getting all the assets," he says. "But you can still set up a new contract that is group-based and introduce new investment options, so no new assets can go into the old contracts."


Keep in mind that federal regulations restrict what investments 403(b) plans can utilize, more so than 401(k) plans. "These plans can only use fixed annuities, variable annuities, and mutual funds," Allen says. "There are a lot of investments that a 401(k) plan can use that are not permitted in 403(b)s. They can't use CITs (collective investment trusts), for example, which can do a nice job of keeping investment costs lower."

Advisors can demonstrate real value when they help 403(b) sponsors modernize their investment menu to a simplified number of institutionally priced investments, organized in a "tiering" approach that's understandable for



Earle Allen
Cammack Retirement Group, Inc.

Continued on page 26



Key 403(b) Trends

The 2019 Plan Sponsor Council of America 403(b) Survey found a number of interesting trends in the 403(b) space:

1. Quicker Contribution Eligibility

Nearly a third of organizations now provide immediate eligibility to receive employer contributions.

2. Higher Participation

Participation rates continue to increase – 81.0% of eligible employees have an account balance, up from 75.8% a decade ago.

3. Higher Deferral Rates

Participants contributed an average of 6.6% of pay, up from 6.3% in 2017 and 5.4% of pay in 2011 when it was first tracked in the survey.

4. Bigger Average Account Balances

The average account balance has nearly doubled since the survey began tracking it in 2011 and is now \$86,697.

5. More Generous Employer Contributions

Organizations contributed an average of 5.5% of participants' pay in 2018, up from 4.7% in 2017.

6. More Investment Structure

More than 60% of respondents now use an investment policy statement (IPS) – a 40% increase in the last 10 years.

7. Improvements in Automatic Enrollment

Automatic enrollment is now in place at one-in-five (21.8%) responding organizations. Nearly 40% of those plans (37.7%) use a default deferral rate higher than 3%.

8. Healthy Focus on Financial Wellness

A quarter of organizations have a formal financial wellness program.

9. IRS Audits

The percentage of organizations indicating they have undergone an IRS audit in the past has nearly doubled from 8.1% in 2016 to 15.4% in 2018.

10. More Participants Getting Help

More than a third (34.1%) of participants availed themselves of investment advice when it was offered. More than half of organizations (53.4%) use a retirement plan advisor separate from their service provider.

The Plan Sponsor Council of America (PSCA), part of the American Retirement Association, conducted its annual survey of 403(b) plan sponsors in the spring of 2018. Sponsored by Principal Financial, the survey received responses from 580 non-profit organizations that currently sponsor a 403(b) plan for their employees. Respondents represented a wide range in size and industry – from small community-based organizations to large hospital and university systems. More information is available at www.psc.org.



David Hinderstein
Strategic Retirement Group, Inc. (SRG)

Continued from on page 24

participants, Schmitt says. “Historically, it has not been uncommon for these plans to offer the full array of funds their provider has,” he says. “So we talk to these sponsors about paring down the menu when appropriate. Our overarching view is to try to eliminate distractions, to help participants make better decisions.”

4. Help Participants Transition to Lower-priced Investments

Some 403(b) plans now have low-priced institutional options similar to 401(k) plans, Hinderstein says. But sometimes a significant amount of a plan’s assets remain in less-transparent guaranteed products that can’t be moved without the consent of participants who hold those assets. “As an advisor, you can help participants move that money from higher-priced investments to lower-priced ones,” he says. “And in some cases you can negotiate with (guaranteed product) providers on participants’ behalf. There is a lot you can do. You have to tackle it, because running away from it doesn’t help.”

Lander has seen a lot of 403(b) participants still stuck with “some pretty bad (retail) annuity contracts” they entered into years ago. “A knowledgeable 403(b) consultant will recognize that these assets cannot be controlled by the plan sponsor,” she says. “So as an advisor, these annuities

are constantly hanging over your head. It’s frustrating. All you can do is get in front of the employees and talk to them about the old annuities and how they compare less favorably to the new funds and structure.”

It’s hard work to convince participants who’ve been in individual contracts for years to switch into a plan’s institutional mutual funds, Allen says. It means dealing effectively with participant inertia, and also trying to reach some participants who no longer work at the organization. “The way to get them to move the money is to explain the benefits to them of moving the money,” he suggests. “You need to have a good story to tell. Usually, if people switch, it’s a function of the pricing. You can explain, ‘Look, this variable annuity you have costs 2%, and you can move to mutual funds in the plan that cost 0.5%, and here’s how much that difference in fees is going to save you over time.’”

5. Recordkeeper Consolidation and Fee Benchmarking

There has been a lot of progress in the 403(b) space over the past decade, Schmitt says. “But if you look at the evolution of the 401(k) space, the 403(b) space is about a decade behind,” he says. For example, it’s not unusual for these plans to have multiple recordkeepers. “Ten or 15 years ago, it was not uncommon for a 403(b) plan to have four, five, or six recordkeepers,” he says. “Today, we work a lot on helping these sponsors consider the advantages and disadvantages of vendor consolidation, whether that is to a single recordkeeper, two, or three recordkeepers.”

These sponsors also understand now that they need to ensure the ongoing reasonableness of their plan fees. “Because of all the lawsuits against 403(b) plans, obviously we’re doing a lot more fee benchmarking,” Bartkus says. “These plans may grow slower than 401(k) plans, but they are growing, and they do have some leverage.”

6. Participant One-on-Ones

The participant side of 403(b) work differs from 401(k) work, Bartkus says. “It’s a lot of one-on-one meetings, a lot of person-to-person help, and I enjoy that,” he explains. “Advisors I know who only work in the 401(k) space will sometimes say to me, ‘Oh my gosh, you talk to the participants directly?’ Lots of 401(k) advisors don’t do that.” But many 403(b) participants need individual help to save for retirement, he says, because they tend to not make a lot of money and not have much experience with finance and investing. “In many cases, if I don’t sit with them and explain what to do to sign up and how to fill out the paperwork, they may never do it,” he says. “So they’d never start saving for retirement.”

Working one-on-one with 403(b) participants also can mean adjusting expectations for an advisor used to 401(k) plans. “For me, it’s mostly about being understanding and empathetic,” Bartkus says. “Be empathetic that a \$5 or \$10 payroll contribution, while it may not be enough to save for retirement, is something. I think advisors who don’t have a history of working with 403(b) plans need to

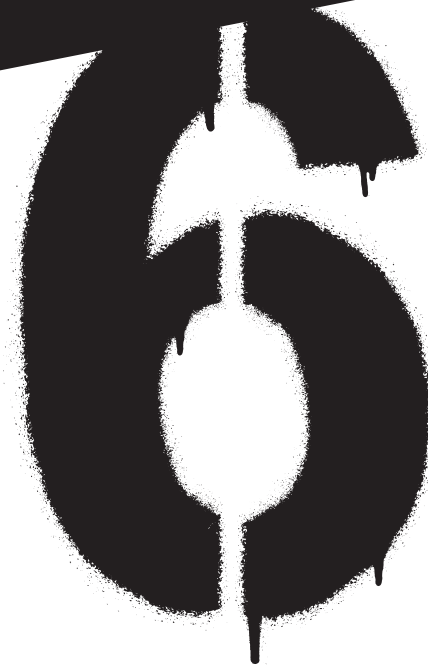
understand that it is okay to help them contribute just a little bit.”

The service model in this market also has traditionally been to have more direct participant contact when “disruptive events” like a recordkeeper switch or investment-menu consolidation happen, Schmitt says. “We tell plan sponsors that we’re going to receive phone calls or emails from a small number of participants,” he says. “There is no doubt that there are going to be people upset when you reduce the investment choices and/or eliminate vendors. So we work with plan sponsors on strategies to mitigate the volume of calls that we’ll receive.” That can mean proactively doing on-site meetings to explain the changes happening and give employees the opportunity to ask questions and voice concerns to someone other than their employer.

In his years working with 403(b) plans, Hinderstein has seen that different not-for-profits have different levels of engagement within their employee population. Don’t presume to know what motivates them, he suggests. “It’s really getting in there and understanding what gets their employees to act,” he says. “We do that by having conversations with them. We’ve had focus groups at many of our not-for-profit organization clients. We ask employees, how do they feel about their retirement plan, and why? What do they wish they had in the plan that they don’t? Do they anticipate retiring from the organization, and if not, why not? As the advisor, you’ve got to do the work if you want to get the answers. You can’t just look it up on Google.” **N**

NOTE: Look for a special session on working with 403(b) plans at the 2020 NAPA 401(k) Summit, April 26-28. More information is at <http://napasummit.org>.

» Judy Ward is a freelancer specializing in writing about retirement plans.



“If you want to be in the not-for-profit space, you need to first understand their culture and the terminology nonprofits use, a nonprofit client’s business strategies, and the legacy issues that 403(b) plans have.”

– Ellen Lander, Renaissance Benefit Advisors Group

MISSING THE TARGET?



TARGET DATE FUNDS
STILL HAVE
DIFFERENCES
THAT COULD
IMPACT THEIR
VOLATILITY
IN THE NEXT
BIG DOWNTURN.

BY JUDY WARD



WHAT DID TARGET DATE FUND PROVIDERS LEARN FROM THE MARKET CRASH A DECADE AGO? NOT MUCH, FOR SOME PROVIDERS, BELIEVES RICHARD WEISS, CHIEF INVESTMENT OFFICER—MULTI-ASSET STRATEGIES AT KANSAS CITY-BASED AMERICAN CENTURY INVESTMENTS.

The subsequent lengthy bull market has motivated some TDF providers to allocate more to equities, Weiss thinks. “The reason that some providers have done so well is that they’ve loaded up on equities, especially mega-cap U.S. tech stocks. Target date providers were getting pressure from clients and advisors: ‘Why aren’t you getting a higher return in this bull market?’” he says. “But the next time there is a big decline in the market, that is going to lead those providers to go off the cliff. It will be a wakeup call for some plan sponsors and participants on how risky an investment they’ve morphed into. Others will realize how risky their target date fund always has been, which they haven’t realized yet because they’ve only gotten in during the past 10 years, in the bull market.”

Not that the past decade has led target date providers to adopt cookie-cutter glide path philosophies and sub-asset class allocation approaches. “They are still created pretty differently across providers,” says Scott Donaldson, senior investment strategist at Valley Forge, Pennsylvania-based Vanguard Group. “There are differences in the level of aggressiveness of the glide path, from an equity standpoint. And within the glide path, there is a diverse set of strategies in how the providers have implemented it.”

‘RANGE’ ROVERS?

Today’s target date funds typically have a relatively narrow range of equity allocations in the funds for investors early in their career, says Jeff Holt, Chicago-based director of multiasset and alternative strategies at Morningstar. “The allocations become more different as you get closer to the retirement date,” he adds. Glide paths more commonly go “through” retirement, he says, but the approaches at and in retirement differ substantially. “If you look at the extremes of equity allocations at retirement, the range exceeds 50 percentage points. One of John Hancock’s series has 8% in equity at retirement, and some providers have more than 60%. The industry average is 43%.”

How target date funds will do in the next extended market downturn depends on what they’re exposed to, Holt says. A decade ago, performance declines went beyond equities to numerous other asset classes. “In 2008, target date funds participated in the market volatility. The question is, will they continue to participate in the next downward market?” he says. “If the 2008 market environment were to happen again, the expectation is that target date funds will again participate in the losses. By and large, the main structure of target date funds hasn’t changed dramatically in the past 10 years.”

The Fidelity Freedom Funds have a slightly higher-than-average equity allocation early on (90% for the 2050 fund versus 88% for the industry average, according to year-end 2018 Morningstar data), then shift into a lower-than average equity allocation during retirement (24% for the 2005 fund versus a 33% average, Morningstar says). “From an overall objective standpoint, we’re trying to deliver something that helps participants maintain their standard of living in retirement,” says Sarah O’Toole, institutional portfolio manager at Boston-based Fidelity Investments. “For younger



SCOTT DONALDSON,
VANGUARD GROUP

“THE NEXT TIME
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— RICHARD WEISS,
AMERICAN CENTURY INVESTMENTS



investors, we're focused on achieving a total-return objective, and we're sacrificing a bit of diversification to do that. Younger investors can better withstand downturns, because they have time to make it up," she says. "Then, as people move closer to retirement and beyond retirement, our focus for participants is on providing diversification and resiliency across different market environments."

The Principal LifeTime Funds' allocation aligns closely with the industry averages early in the glide path, but then shifts into a lower-than-average equity allocation in retirement. (Principal's Strategic Income Fund holds 23% in equity versus a 33% average for 2005 funds, according to Morningstar data.) A couple of main factors influence Principal's design of its glide path, says Randy Welch, managing director and portfolio manager at Des Moines, Iowa-based Principal. It starts with doing Monte Carlo simulations to create an initial, optimally efficient allocation path. The Principal has looked at participant data and behavior across its entire recordkeeping platform, to take into account actual utilization of TDFs.

'HUMAN' CONDITIONS

"We try to manage volatility by being realistic about participants," Welch says, adding that those in TDFs tend to have lower balances than other participants. "If I just run Monte Carlo simulations unconstrained, it will say that I need to add more risk to the

portfolio. But we're also sensitive to the human side of this. Many individuals in target date funds who are approaching retirement are somewhat underfunded, but they are also concerned about volatility. Many of these people haven't saved enough, but I don't want to just increase the risk in the portfolio to try to make up for that."

American Century's OneChoice Target Date Portfolios have a glide path that's "unique" and "flatter than most," a Morningstar report says. Between the 2030 fund and the 2010 fund, for example, equity dips from 55% to 45%. "We've stuck with our original philosophy, and we've paid the price for it," Weiss says. "We've



**"IF YOU LOOK
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— JEFF HOLT,
MORNINGSTAR



SARAH O'TOOLE,
FIDELITY INVESTMENTS

lagged the performance of some of the more aggressive target date funds in the past several years. But we are sitting here with a process and a philosophy designed to work through a full market cycle, both a bull and bear market.”

“The reason for our flatter glide path is to minimize the ‘sequence of returns’ risk, meaning the risk of getting caught in an ’08 scenario right before you’re about to retire,” Weiss says. “It’s designed to smooth out returns over time.” He describes American Century’s TDFs as best suited for sponsors “concerned most about getting the highest proportion of their participants through to a successful retirement, not necessarily with the most money.”

‘DIFFERENT’ STROKES

The Vanguard Target Retirement Funds maintain an equity glide path that matches up closely with industry averages throughout, Donaldson says. Vanguard seeks to balance risks that participants face equally, he says. “Investors in target date funds have many risks to contend with, and there are many different investment strategies to focus on certain risks,”

WHERE PARTICIPANTS NEED MORE HELP

As a growing percentage of plan assets flow into target date funds, investor data and analytics firm Hearts & Wallets, LLC has asked more than 50,000 Americans about their saving and investing habits. One theme that has emerged: People need more help than they’re getting from today’s packaged investment products.

A few of the insights from Rye, New York-based Hearts & Wallets about where people say they need help:

Clarifying retirement plans: Just 43% of consumers surveyed say they know what age they or their spouse plan to stop working full time. “For many people in target date funds, their retirement date may not even be something that they know,” CEO and founder Laura Varas says. “A key question that many consumers want help with is how long they should plan to work. The target date of their retirement is something they’re looking for as an output, but it’s something that they’re being asked to provide as an input.”

Prioritizing savings goals: Seventy percent of consumers say they have two or more saving and investing goals – with building up an emergency fund ranking first overall – so a message to focus only on retirement savings doesn’t resonate with many consumers. “What we hear is that they never really believe advice that is delivered through one lens. So they don’t trust advice that says they should focus 100% of their savings on retirement,” she says. “People have multiple financial priorities, and to focus only on retirement just doesn’t make sense. If you give advice that is too narrowly focused on retirement, consumers are smelling it for what it is.”

Getting individualized investment advice:

The answer on how to facilitate participants getting individualized investment advice may not be in-plan, but more akin to what robo-advisors now offer retail investors, Varas says. “The solution may lie in being able to buy (retail) advice and also keep their money in their employer’s or former employer’s plan,” she says. She sees strong potential consumer interest in an advice product that wraps around target date funds, and may include an income component. “The employer could facilitate that, or not,” she says, “but at least that type of advice should not be blocked by a plan’s recordkeeper.”



LAURA VARAS,
HEARTS & WALLETS



“OUR BELIEF IS THAT FIXED INCOME, AND THE LEVEL OF DIVERSIFICATION THAT A TDF HAS WITHIN FIXED INCOME, IS BY FAR THE BEST WAY TO ADDRESS VOLATILITY.”

– JOE MARTEL,
T. ROWE PRICE

he says. “We think that it is important to account for many types of risk. With a glide path design, you are making one selection for many people, who are in many types of situations.”

“If you talk to participants, you’ll find that they have different weights placed on different risks for each individual,” Donaldson continues. “Plan sponsors selecting a target date fund family need to put their fiduciary hat on, in the sense that they need to balance the different risks. You want the product that they believe might do the best for the most investors, and not one that focuses on one particular risk characteristic.”

The Retirement Series of T. Rowe Price’s target date funds has a higher-than-average percentage of equity around retirement: 55% for the 2020 fund, versus the 44% industry average that Morningstar cites. T. Rowe Price’s investment philosophy for the TDFs emphasizes longevity risk. “Our primary objective is supporting investors’ ability to have lifetime income, so that people do not run out of money,” says Joe Martel, a portfolio specialist at the Baltimore-based firm. “We also want to help overcome the reality that many participants are undersaving as a percentage of their income. The vast majority of participants save under the 15% general rule of thumb about how much people should save for retirement – and if they are saving 15%, it’s usually back-loaded during the later years of their career.”

DON’T GET FOOLED

Target date funds still differ in how they seek diversification, Holt says. “The equity glide path just scratches the surface of the differences between TDFs,” he says. “The sub-asset class differences are still pretty prevalent. That’s where you see the differences in how much they allocate to investments like TIPS (Treasury Inflation-Protected Securities).”

Understanding target date funds requires going deeper than just knowing the equity versus fixed income breakdown, Weiss says. The glide path philosophy should filter down to the sub-asset class decisions and the individual stocks and bonds held, he says.

“In the target date fund world, the shorthand is to simply look at the glide path, which just shows the percentage of equities

and the percentage of bonds, and which can easily be ‘gamed,’” Weiss says. “You can masquerade as a low-risk glide path by having a low equity exposure, but getting juiced up on exposure to things like commodities. It is critical to look at the next level of asset allocation, so you don’t get fooled.”

That’s especially important for understanding a target date fund family’s risks for those in or near retirement, says Weiss, who believes that protection against downside risks should dominate then. “It’s the diversification more than anything that matters at that point,” he says. “Concentrations are the enemy of a retiree.”

For Fidelity, its sub-asset class investment decisions revolve around increasing diversification, O’Toole says. “It’s a balance between growing the assets and protecting the assets,” she says. For example, in 2018 the Freedom Funds made allocations to TIPS and long-term Treasuries, to help with inflation risk. “We are focused on increasing diversification, given the uncertainty about the markets in the long term,” she says. “And inflation protection gets more important as investors age.”

Some target date funds have diversified more within fixed income the past few years. T. Rowe Price has added long-duration Treasury bonds and an absolute return fixed income strategy, for example. “While we believe that longevity risk should be the focus, that doesn’t mean we ignore volatility,” Martel says. “Our belief is that fixed income, and the level of diversification that a TDF has within fixed income, is by far the best way to address volatility. Because in the end, equities are equities.”

Vanguard now allocates 30% of its TDF fixed income portfolio to non-U.S. fixed income, Donaldson says. “Investment-grade, non-U.S. fixed income can be a pretty strong diversifier,” he says. “Having a combination of high-quality fixed income is important to reduce equity risk. The real value of fixed income in a target date portfolio is not return generation, but the volatility and risk mitigation.”

Market risk remains the greatest risk of a target date fund portfolio, whether a TDF allocates 80% or 20% to equity, Donaldson says. “Being broadly diversified across many different asset classes is one way to control downside risk,” he says. “One of the most common ways to do that is diversifying away from U.S. equities into non-U.S. equities, in both developed markets and emerging markets. It’s one of the few ways that you can diversify equity risk without moving out of equities.”

Vanguard has made several sub-asset class tweaks over the past decade, Donaldson says. “Most of those were in some way related to gradually increasing the global diversification of the funds,” he says, “moving more assets into non-U.S. equities and fixed income.”

In the spring of 2019, Fidelity increased the diversification of the Freedom Funds’ equity exposure, O’Toole says. “We moved from 70/30 in U.S. versus non-U.S. equities to a 60/40 allocation,” she says. “We want to preserve the home-country bias, because participants are funding U.S. dollar-based liabilities (their retirement-expense needs).”

International equity and fixed income holdings have increased among target date fund managers the past few years, Holt says. “Within the sub-asset classes, we’ve seen a move away from as pronounced a home-country bias,” he says. “Most of the TDFs are still weighted toward U.S. equities, but less so.”

HELPING SPONSORS GET CLARITY

Sponsors need plan advisors to help them ensure they’ve matched the right target date fund family with their participant base and plan. “It’s about understanding the goals of the target date provider, and how that aligns with the goals of the participants and the sponsor,” O’Toole says.

To help sponsors decide, Welch suggests working with a plan’s provider to get TDF utilization data for a sample of the participant population. “They can look at the individual characteristics of those participants,” he says. “We look closely at the ‘belly’ of the age curve, from age 50 to normal retirement age. What sort of account balances do they have? What are their deferral rates at that point? If most of the participants have large account balances and are coming into their retirement funded adequately, the sponsor may want a target date fund that’s more conservative, because those participants have got plenty of assets. But other sponsors will want something more aggressive in that case.”



RANDY WELCH,
PRINCIPAL

Utilizing the right target date family ultimately boils down to an employer’s philosophy, Martel believes, and he sees advisors playing a key role to help employers clarify that. “First, it’s helping them determine, what is their objective? Who are you trying to solve for: Is the employee population they’re focusing on those around retirement, or younger workers, or do they weight those populations evenly?” he says. “Then it’s looking at the different types of risks and outcomes: Do they want to put a greater emphasis on longevity risk, or do they want to limit volatility around retirement? Help them understand the tradeoffs.”

Sponsors need to understand the implications of prioritizing market risk or longevity risk, Martel says. “The cost of getting lower volatility will be lower balances at retirement,” he continues. “Some sponsors are willing to accept more volatility to increase the chances that their participants will retire with enough income in retirement. But it is perfectly reasonable to say, ‘I’ll take lower balances at retirement to have lower volatility.’” ^N

» Judy Ward is a freelancer specializing in writing about retirement plans

THE ADVISOR *Experience*

IT'S THE ONE RETIREMENT
ADVISOR EVENT YOU
CAN'T AFFORD TO MISS!

BY NEVIN E. ADAMS, JD

YOUR ATTENDANCE AT THE NAPA 401(k) SUMMIT IS, AND REMAINS, A UNIQUE INVESTMENT IN YOUR FUTURE – AND THE FUTURE OF YOUR PROFESSION.

WHY IS THE NAPA 401(k) SUMMIT DIFFERENT?

We make a point of saying that this is the only retirement plan advisor conference developed by plan advisors for plan advisors. The proof of that is in the program that has been developed – for you.

The agenda, developed with input from thousands of retirement plan advisors, is further shaped, refined, and ultimately built, by a steering committee of leading advisors and other industry professionals; a practical, action-oriented program developed by advisors for advisors.

The planning for the 2020 Summit literally began an hour after the conclusion of the record-breaking 2019 event, with an on-site debrief of the flow, the sessions, the speakers, and of course the networking activities, by the 2019 steering committee.

THE LEARNING EXPERIENCE(S)

This year, as in years past, the 2020 steering committee (98% are advisors – committee

members hold their position for a two-year period, with, at the discretion of NAPA leadership, an optional third year of service) has been hard at work for months, developing the program, fleshing out the agenda, lining up speakers, and beginning the process of assigning session “owners” to make sure that you get maximum bang for your buck in terms of information, interaction, and session quality. As you can see from the tentative workshop lineup nearby...

Are you worried about helping your clients through a DOL audit? We’ve got you covered. Not sure how to best set a reasonable fee for your services? No problem. Want to incorporate HSAs into your focus? Check. Thinking about selling – or merging – your practice? Expanding your team? Benchmarking? We’ve got your back. Worried about litigation? Cybersecurity? Check, check.

There’s no “pay to play” – nobody “buys” a speaking slot at the Summit – and fully half of our “workshops” are focused on practice building/practice management (see page 40 for our preliminary agenda – updated in real time at napasummit.org).

Not to mention our extra-special “peer-to-peer” session, where you’ll be able to contemplate, collaborate, and communicate regarding some of the most significant issues for your business in a unique setting.

And that’s not all – you’ll want to stay tuned to NAPA-Net’s “Daily” for an announcement about an exciting new presentation forum on an array of topics that could run the gamut from ESG, to social media, managed accounts vs. TDFs, CITs, blockchain, TPA partnering, managing rollovers, litigation tips, and much, much more.



THE ASPIRATIONAL EXPERIENCE(S)

Attendees will have the opportunity to hear from the industry’s thought leaders and innovators while networking with the Summit’s 2,300+ attendees, half of whom were advisors at the 2019 event. Attendance is expected to be even higher this year due to pre-registration demand and expanded conference offerings. Retirement plan advisors attending the event also participate in the annual Summit Insider survey and receive the results in a special supplement to *NAPA Net the Magazine*.

As for our general sessions – you can always count on the most timely topics, the best speakers, the most dynamic sessions. Already announced for 2020: retired Navy Seal Marcus Luttrell, the featured subject of the major motion picture, *Lone Survivor*.

And nobody, and I mean nobody, brings “the Hill” to the Summit like NAPA!

THE NETWORKING EXPERIENCE(S)

If you’re focused on networking (and who isn’t?), Summit “After Dark” has transformed the concept into a true advisor “experience.” If you’ve been there, you know what I mean. If you haven’t, trust me, you don’t know what you’re missing (though doubtless you’ve heard).

This year, we kick off After Dark by taking over a chunk of the Universal Studios theme park. You can walk there





from the event hotel properties – or, if you prefer, cruise over on a series of water taxis (tickets can be purchased for spouses, significant others and kids) to join this unlimited ride(s) experience. That experience includes riding the “Rip Ride Rocket,” an amazing roller coaster that runs throughout the whole park, encounters with larger-than-life Transformers, not to mention (and yet I am) “Joliet” Jake and Elwood Blues – you might know them as the Blues Brothers.

On the second night, you’ll have an opportunity to experience Universal CityWalk, the “epitome of awesome.” We’ve bought out the Red Coconut Club, Bob Marley’s, The Groove Nightclub,

Pat O’Brien’s and more to bring you an exclusive evening of live music, open bars and nightlife – not to mention an opportunity for you to contribute personally to the live music experience... at CityWalk’s Rising Star live karaoke club!

THE REAL ‘EXPERIENCE’

Beyond all those valuable and fun experiences, there are two other major considerations in attending this year’s NAPA 401(k) Summit. First, there is the critical issue of legislative and regulatory reform. The mid-terms shifted the balance of power – but a year out from the 2020 elections, it’s nearly impossible to predict what lies ahead, and what that might mean

for retirement reforms – and that doesn’t take into account what might emerge on the regulatory side from the Labor Department, the SEC, or both, particularly if the Democrats take the White House. Regardless – you will want – and need – to know what is afoot, and what might be coming down the pike, and there is no better place for you to do that than the NAPA 401(k) Summit.

But among all the things that really (really) set the NAPA 401(k) Summit apart – one thing stands out, this year more than most. Quite simply, it is that – unlike every other advisor conference out there – your NAPA 401(k) Summit registration helps support the activities of NAPA – your advocacy, information and education organization – not the bottom line of some corporate media organization or private equity firm.

That’s right – in addition to the insights, information, networking that you may get at some other events, your attendance at the NAPA 401(k) Summit is, and remains, a unique investment in your future – and the future of your profession.

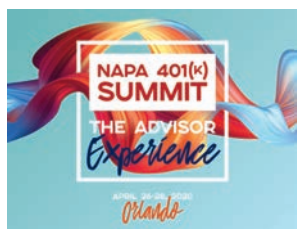
It is, quite simply, a great way – perhaps the best way – to put your money where your mouth is.

So, go ahead – register for the NAPA 401(k) Summit. Today. While you’re thinking about it. Now. You’ll be glad you did.

Everything you need to know is at www.napasummit.org.

The 2020 NAPA 401(k) Summit. It’s the nation’s retirement plan advisor convention – the “can’t miss” retirement plan advisor event of the year.

You won’t want – and you can’t afford – to miss it! **N**



(TENTATIVE) WORKSHOP LINEUP FOR THE 2020 NAPA 401(K) SUMMIT

THE BOTTOM LINE

“Top” Tips: Rising to the Top in the Race to the Bottom (SA)

Amidst continued pressures on fee and service, the most successful advisors have excelled at highlighting those essential, but sometimes intangible elements that help them stand out from the competition. Everyone loses in the “race to the bottom” – learn how to win by putting more value into your value proposition.

Profit “Able”: How to Work With Small Plans and Still Make a Profit (CD)

It's one thing to focus your practice on the smaller end of the market – something else altogether to do so profitably. Gain key insights on building a viable service model that provides the fiduciary support small plans need alongside the bottom line you need to maintain. A follow-up to last year's standing-room-only session on the opportunities in the small plan market.

Win When: Felix Exitus or Success-a-Rama (a.k.a. Measuring Success) (DP)

Measuring success is something with which our industry continues to struggle. In this session, we'll focus on two distinctly different measures of success: Client success and the advisor's success. We'll do so via three different 10-minute presentations followed by a question-and-answer session focusing on these two different measures of success.

PRACTICE BUILDING

“Path” Finders: Developing a Career Path That Can Keep Your Practice on Track (JG)

Finding good talent is hard... keeping that talent can be even harder. Insights on developing, building, and sustaining that growth – from teams that have fostered a culture of growth and support to create sustainable business models.

“Different” Strokes: Managing and Motivating a Diverse Workforce (AP)

Career paths are one thing – but weaving together disparate views and viewpoints in

today's multi-dimensional workplace can present challenges for even the most vibrant and innovative. Find out what works – and what hasn't – and why – from these out-of-the-box thinkers (and doers)!

Habits “Forming”: Five Habits of Highly Successful Advisors (PR)

Wirehouse, aggregator, or independent? That may drive the support structure for your practice, but at the end of the day successful retirement plan advisors share certain habits, and the key to sustaining success is a repeatable process – not managing individual projects. Hear three of the nation's leading advisors share their best practices in five distinct areas over the lifecycle of your client relationships: business development, onboarding new clients, client reviews, the participant experience, and benchmarking/record keeper searches.

Differentiate “Ed”: How to Differentiate Your Practice in an RFP

In a world increasingly driven by fixed templates masquerading as Requests for Proposal, how can you set yourself apart and take it to the next level of consideration? This panel will not only explore how the best sales organizations differentiate themselves when invited to respond to an RFP, but take that from the response, to the finals, to the follow-up, as we look across industries to bring the best ideas to help you win more business.

Managed “Cure”: Why Managed Accounts Matter More (VM)

There's more than one way to build, manage and maintain a managed account – and a growing number of advisory firms are launching their own version of managed accounts. You'll hear from some of the nation's leading advisory firm architects of these managed accounts, and gain insights on the importance of this new, more customized approach to plan sponsors, participants, recordkeepers and you as the advisor in terms of enhanced participant engagement, better retirement outcomes and ultimately – a better 2.0 QDIA.

“Best,” Stressed: Attracting, Developing and Keeping a Unique and Diverse Team

By 2055, the U.S. will no longer have a single racial or ethnic majority. Those who prioritize diversity and inclusivity in the workplace effectively hold a distinct advantage in attracting, recruiting and retaining talent. But it doesn't stop there. Through increased creativity and innovation, diverse and inclusive organizations achieve new heights contributing to their long-term success. Join us a conversation on what diversity and inclusivity mean, how forward-thinking industry leaders attract some of the best talent our industry has ever seen, and what they do to foster a culture of inclusion and opportunity.

Cyber “Security”: Tips, Tacts & Tools to Keep Your Data & Business Secure

Cyber and security continues to be a major topic in the 401(k) industry – and there's tremendous interest from advisors to hone their knowledge of current topics. Doug Peterson is Chair of the SPARK Institute Data Security Oversight Board. He's a talented speaker with a broad lens of what's going on in the industry – recent attacks and case studies, how to protect against them, checklists for what you should ask a provider and what you should do to protect your own data.

SOLUTIONS ORIENTED

“Know” Way: The Retirement Savings Tool Most (Still) Aren't Using (BC)

Surveys continue to show that workers and retirees alike are more concerned about health care costs in retirement than any other element. And yet the most underutilized tool in the retirement savings arsenal is specifically designed with that purpose in mind. Plan sponsors say that education is the #1 challenge to health savings account adoption by participants – but participants aren't the only ones with a knowledge gap. Find out what you need to know to help them evaluate the option.

“Wrong” Headed? : What's Wrong With Wellness? (SH)

What's wrong with financial wellness? Heck, we can't even agree on what it is. It sounds



good, but it takes time, money and effort. And the ROI? Well, let's just say it's elusive. Disagree? Well, come find out from this expert panel not only what's "wrong" with today's financial wellness focus, but what you should be doing instead.

'C' Sweet: Starting (and Ending) a Successful Executive Benefits Conversation (JW)

When a 401(k) just isn't enough to help you stand out – or to get you access to the C-suite, a non-qualified plan solution can be just the ticket. Join us for real life stories of companies and situations, where the most common potential client need is the non-qualified plan. Learn how to bring it up and how to call in the cavalry. There is a ton of additional revenue opportunity in this space and no need to overcomplicate it.

"Out" Takes: The Outcomes for Retirement Income (MM)

As participants begin to shift from saving to spending, understanding participant behavior is more critical than ever as defined contribution plans continue to evolve. How we solve the challenges of helping participants live in retirement on the savings set aside while working is the ultimate test of a retirement plan advisor's mettle. Are today's alternatives

"enough" – and if they are, why do so few embrace them today?

"Troubles" Talk: Are Your Clients an Audit Target? (AK)

Regulatory scrutiny seems to be at an all-time high. Are the activities of your plan sponsor clients setting them up for an audit? Find out the triggers for those reviews, what you can do to avoid getting into trouble – and what you can (and should) do once that audit has begun.

Out of Control? The 'B' Leaguered Legacy of Certain 403(b) Plans

What do you do with a 403(b) plan that has legacy assets invested in annuity products that are not under the control of the plan sponsor? Sure, you can "fix" things going forward, but then you're stuck with the older assets, oftentimes invested with people who no longer work for the organization. We'll focus on what the issues are, the potential solutions and the communication of a bifurcated menu.

FUTURE FOCUSED

Generation Hexed?: Defusing the Financial Time Bomb of Gen X (LB)

Like no modern generational cohort, Gen X is hitting its prime earnings years squeezed between the financial pressures of aging parents and college debt-laden children. Often overlooked in

retirement planning, this first 401(k) generation has a unique set of challenges – and your practice can benefit from a unique set of effective strategies to not only engage Gen X, but to help this "forgotten" generation get on track.

Building "Blocks": The Future is Female (KD)

Whether you are working to build and expand your practice, or looking to leverage current opportunities by diversifying your perspectives, you'll glean amazing insights from this panel of NAPA Top Women Advisors – on the best practices for female advisors, the challenges they have encountered and overcome, how they are uniquely positioned to win and retain business in the future, and the outreach they are making to a whole new generation of advisors – exclusively at the NAPA 401(k) Summit!

Future "Tense"?: The Retirement Plan Practice of the Future (CM)

What will your practice look like a decade from now? How might shifts in regulation, legislation, demographics, technology and the markets influence not only what you do, but how you do it? Your practice of the future has to be constructed for scale, and it will take a team effort across the industry. Learn how to get in on the evolution now... **N**

ROLLOVER RECOMMENDATIONS

Under the SEC's Best Interest Standard

Here's what has changed, what hasn't changed, and what advisors should be doing now.

By Joshua J. Waldbeser & Fred Reish

On June 5, the SEC finalized its “best interest” rulemaking package, including:

- » Regulation Best Interest: The Broker-Dealer Standard of Conduct (“Reg BI”), governing recommendations to retail customers by broker-dealers;
- » Interpretation Regarding Standard of Conduct for Investment Advisers (“RIA Interpretation”); and
- » Form CRS Relationship Summary; Amendments to Form ADV (“Form CRS”).

Note:

This is our third article in *NAPA Net the Magazine* on the issue of plan-to-IRA rollovers. Readers may wish to review our previous contribution from the Summer 2018 issue, “Recommending Rollovers: What Advisors (Still) Should Know and Do,” and particularly our contribution to the Spring 2019 issue, “Recommending Rollovers: What the SEC Says Advisors Need To Do,” as important background.

– JW, FR.

Compliance with Reg BI and the Form CRS requirement is mandatory as of June 30, 2020. The RIA Interpretation, on the other hand, simply reflects and clarifies the SEC’s view on the duties that RIAs owe their clients as fiduciaries under the Advisers Act – and thus is “effective” already.

It is no surprise that rollovers are a point of emphasis in the final rules – this was also true of the proposed rulemaking. The final rules apply to rollovers from all “workplace retirement plans,” including both 401(k) and other ERISA-covered plans, and non-ERISA plans such as governmental 403(b), 457(b) and pension plans.

WHAT HASN'T CHANGED?

To avoid repetition, we assume that readers have at least browsed our Spring 2019 article, which addressed rollovers in the context of the proposed SEC rulemaking, and we pick up from there.

First, as anticipated, the final rules embrace certain existing aspects of SEC and FINRA guidance, as well as the vacated DOL fiduciary regulation. For rollovers from 401(k), 403(b) and other participant-directed plans, the rules indicate that advisors must make a reasonable determination that a plan-to-IRA rollover

would be in the best interest of the customer. (For ease of reading, we use “advisors” to include both investment advisers and broker-dealers. As that suggests, in our view, the requirements for rollover recommendations are the same under both Reg BI and the RIA Interpretation.) In that regard, advisors should take into account both:

- » certain factors summarized in our previous articles, which, according to Reg BI’s release for the final regulation, “should generally include, among other relevant factors: fees and expenses; level of service available; available investment options; ability to take penalty-free withdrawals; application of required minimum distributions; protection from creditors and legal judgments; holdings of employer stock; and any special features of the existing account,” and
- » the customer’s profile, including at least his or her “age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, (and) risk tolerance.”

This determination must be reasonably comprehensive and tailored to the



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participant. It is not merely a matter of counting the factors that would favor an IRA against those that would favor leaving the customer's savings in the employer's plan, as the SEC observes that "certain factors may have more or less relevance, or not be relevant at all," from case-to-case. And certainly, it is not sufficient to assume that an IRA is a superior choice across-the-board owing to one or two boilerplate differences. For example, Reg BI's release warns that: "...we caution broker-dealers not to rely on, for example, an IRA having 'more investment options' as the basis for recommending a rollover."

Similarly, the SEC's final rules likewise confirm that for broker-dealers and investment advisers alike:

- » rollover recommendations involve material conflicts of interest which must be disclosed to retail investors; and
- » copies of Forms CRS must be furnished to investors when (or before) a

recommendation is made to roll assets from a workplace retirement plan into an IRA, and regardless of whether the rollover IRA would be a new account, or merely an addition to an existing IRA.

Finally, while there is greater discussion of the process for rollover recommendations in Reg BI than in the RIA Interpretation, in our view there is no meaningful difference in the standards for broker-dealers and investment advisers. We discuss why we believe this is true in our previous articles, and nothing in the final rules would cause us to revisit that conclusion.

WHAT HAS CHANGED?

First, unlike the proposed rules, the SEC's final rules make it clear that recommendations of "account types" are subject to the best interest requirement. The Reg BI release explains that:

"We are modifying Regulation Best Interest to expressly apply to account

recommendations including, among others, recommendations to roll over or transfer assets in a workplace retirement plan account to an IRA... and recommendations to take a plan distribution for the purpose of opening a securities account." (Emphasis added)

This expanded scope raises some subtle but important distinctions. In particular, FINRA Regulatory Notice 13-45, which interprets FINRA's existing suitability standard in the context of rollovers, states that:

"A recommendation concerning the type of retirement account in which a customer should hold his retirement investments typically involves a recommended securities transaction, and thus is subject to Rule 2111. For example, a firm may recommend that an investor sell his plan assets and roll over the cash proceeds into an IRA. Recommendations to sell securities in the plan or to purchase

securities for a newly opened IRA are subject to Rule 2111.” (Emphasis added)

Under Reg BI, the SEC explains the difference as follows:

“...FINRA’s suitability standard applies to recommendations of rollover decisions that involve securities transactions, **but not necessarily in the absence of a securities transaction**...Regulation Best Interest explicitly applies to account recommendations as an “investment strategy involving securities,” including recommendations of securities account types, as well as rollovers or transfers of assets from one account to another.” (Emphasis added.)

In short, it’s clear that all rollover recommendations by broker-dealers will be subject to Reg BI’s best interest requirement regardless of whether or not they involve securities transactions. And, since all advice by investment advisers is subject to their best interest standard, all rollover recommendations by investment advisers and broker-dealers are subject to the standard.

Second, the SEC’s final rules state explicitly that costs must always be considered – in addition to potential risks and rewards – when making any recommendation to a retail customer. Since rollover IRAs are usually more expensive than plan accounts, the additional cost must be justified by additional benefit(s) for the participant based on the participant’s needs and objectives.

WHAT SHOULD ADVISORS AND FIRMS BE DOING NOW?

So what does all this mean in a practical sense?

Broker-dealers are required to be in compliance with Reg BI by June 30, 2020. And the RIA Interpretation reflects the SEC’s already-existing views of RIA responsibilities under the Advisers Act – in other words, it’s applicable now.

Many firms have already established protocols for collecting and analyzing plan (and IRA) information, and documenting their “best interest” determinations for rollovers in preparation for the DOL’s vacated fiduciary rule and Best Interest Contract Exemption (BICE). And advisors

UNLIKE THE PROPOSED RULES, THE SEC’S FINAL RULES MAKE IT CLEAR THAT RECOMMENDATIONS OF “ACCOUNT TYPES” ARE SUBJECT TO THE BEST INTEREST REQUIREMENT.

who are fiduciaries to ERISA plans are likely to be using that process in practice, to ensure compliance with the DOL/IRS temporary enforcement policy outlined in Field Assistance Bulletin (FAB) 2018-02 (discussed in our previous articles).

Since the considerations under the DOL and SEC rules largely overlap, these practices should, at very least, provide a starting point. Furthermore, since the SEC rulemaking does not differentiate between rollovers from ERISA plans and non-ERISA plans (only ERISA plans are within the DOL’s enforcement jurisdiction), these practices now need to be expanded to rollovers from governmental 403(b), 457(b) and other ERISA-exempt plans.

One word of caution: Unlike the former DOL rule, the SEC rulemaking does not specifically address whether an advisor can rely on benchmarks or similar data (e.g., as to plan expenses, types of investments, etc.) in cases where plan-specific information is not available. It’s not clear at this time whether the SEC considers this a permissible practice.

Likewise, because the SEC rules cover rollover recommendations from defined benefit plans and non-participant directed defined contribution plans, practices may need to be updated for those types of rollover recommendations.

For example, relevant factors for a DB plan include:

- » the additional risk of withdrawing the benefits from the plan, particularly if the benefits are insured by the Pension Benefit Guaranty Corporation;
- » whether or not the investor would benefit from the guaranteed income the plan offers; and

- » any reductions/adjustments of the plan benefit where it is withdrawn in a lump sum prior to the individual’s normal retirement age.

However, the appropriate “best interest” factors to be considered for rollover recommendations from DB plans and non-participant-directed DC plans have not been developed in the law. As a result, firms and advisors will need to thoughtfully establish criteria for the factors to be considered in developing such recommendations.

Finally, the SEC does not require a “best interest” determination for rollovers that are not recommended by the advisor. It is permissible to provide individual clients with full, fair, and balanced educational materials on the considerations for rolling over, leaving their money in the plan or transferring the account to the plan of a new employer. Firms and advisors may wish to develop, or improve, existing materials to document these situations – in particular where it may be difficult for an advisor to make the “best interest” finding, including where plan information is missing or the plan isn’t participant-directed. **N**

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A Sea of Change for Advisors

Tomorrow's challenge: decumulation in the context of greater longevity.

BY STEFF CHALK

Since the inception of the first pre-tax salary deferral in the early '80s, evening news programs have chronicled the flows associated with 401(k) plans. Tabulation of "How much American workers saved for their own retirement last month" became a featured news story during the first week of every month.

A lot has been learned from the growth of 401(k) plans – but some of what has been learned was not exactly what participants wanted to hear. Participants did not save enough in the '80s and '90s. An arbitrary company match of 100% on the first 3% of compensation deferred into the plan became the norm. But participant balances grew as the roaring bull market masked the anemic saving rates.

Changing the Narrative to 'Save More'

During the 2000s, the mantra became, "save more." This was a wakeup call that still rings true for the majority of plan

participants. "Save more" is not exactly what most plan participants – who thought of themselves as active 401(k) plan savers – wanted to hear. Their thought process was: *"I'm paying 6.2% Social Security tax and 1.45% Medicare tax, and my employer is paying a similar amount... I'm contributing over 15% of my pay to federal savings plans and another 3% from my own 401(k) plan... and you're telling me I'm not saving enough?"*

The concept of saving more was difficult for most participants. In recent years, courageous plan sponsors have embraced the concept of employing workers who can retire at normal retirement age if they choose to do so. It is encouraging to work with plan sponsors who "get it" – not all of them do. But advisors know they are in the right profession when they have the opportunity to enlighten a plan sponsor who is interested in doing the right thing.

Changing the Narrative to Income Generation

Enter one of the biggest challenges the 401(k) system will ever need to communicate: Saving is not easy. Neither is saving more. But converting a 401(k) plan asset base (or a participant account) to a lifetime income stream is even harder. Doing that requires that you explain the concept to plan participants. Nobel Laureate William Sharpe has described the challenge of the decumulation of retirement savings into retirement spending as "the nastiest, hardest problem in finance."

Changing a Variable on Income Generation

There is one more variable that needs to be factored into any income generation strategy. In the '70s, a U.S. citizen could reasonably expect to live to age 70. When plan participants worked until their normal retirement age of 65, there was not a lot of difficulty in computing a spend-down strategy. Life was good, but not expected to be long upon reaching retirement.

Today, life expectancy is 14% longer than it was in the '70s – about 80 years. Assuming the same retirement age of 65, advisors today must be prepared to make a 401(k) nest egg sustain 15 years of retirement.

Future calculations and income generation strategies don't get any easier. Data from the U.S. Census Bureau supports an estimated life expectancy of 104 years for 50% of Americans born in 2017. Since people are expected to live longer, your role in working with retirees will become significantly more complicated.

The role of the retirement plan advisor has changed over the last 40 years – all for the better, as advisors now have more respect and responsibility than ever before. However, the retirement advisors who deliver the most value to clients in the future will be those who are poised to communicate income generation to plan participants while explaining the importance of a sound decumulation strategy during a long and stable retirement. **N**

»Steff Chalk is the Executive Director of The Retirement Advisor University (TRAU), The Plan Sponsor University (TPSU) and 401kTV.



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The Yellow Brick Road of Consolidation

Whether you or a client are undergoing a consolidation, here are some key factors to consider.

BY DAVID N. LEVINE

In this column in 2019, so far I have addressed topics ranging from cybersecurity (and the emerging wave of lawsuits), to privacy (with the California Consumer Privacy Act right around the corner), and the impacts of the next Presidential election. A common theme for these topics is that they will continue to be very high profile in 2020.

Similarly, the focus of this final column of 2019 is another topic that is bound to continue moving forward in 2020: consolidation in the retirement services industry.

In the fall of this year, it seemed that not a day went by without news of another merger or acquisition in the retirement services industry. Mergers have affected all corners of the industry – from recordkeeping and third-party administrators, to investment companies, to advisors.

Where this consolidation will lead is yet to be determined. However, as I watch consolidation every day and deal with the business and legal ramifications, there are a number of considerations advisors may want to bear in mind for both their clients and their own businesses.

Client Considerations

With respect to consolidation of other service providers, advisors can help serve their clients well in a number of ways:

- **Updated Contractual Documentation and Service Changes.** As service providers consolidate, they often decide to retain the contractual paper from one or the other entities or sometimes create a “best of both”

replacement for all of their clients. Given the fact that there are regularly changes in these documents from prior practice, advisors can provide significant value in this review.

- **Changes to Investment Funds.** As investment funds are acquired and consolidate, funds are evolving in a number of ways – from “blender” funds with multiple service providers to renaming/merging of funds. These changes can come quickly, involve cost changes, and raise questions with plan sponsors. Advisors can help prepare for and bridge that divide.
- **Evolution of Products.** With consolidation, the services and products available from single vendors continues to expand. Many of these products can be helpful to participants, beneficiaries and plan sponsors. However, with the proliferation of these products, sorting out what is most useful for a client can be a valuable use of an advisor’s time.
- **Vendor Search.** Inevitably, some mergers and acquisitions will work well with better services, products and efficiency, but others may not. As consolidation occurs, whether for benchmarking or full search, an advisor’s ability to interpret and apply the lessons learned from mergers and acquisitions can be invaluable.

Considerations for Advisors

For their own businesses, consolidating advisors should think about:

- **Disclosure Updates.** Consolidating advisors may suddenly have a number of affiliated entities that are (or may soon be) working with their clients. Ensuring that proper disclosures – whether from insurance regulators, FINRA, the SEC or other regulators – are provided is an important post-consolidation step.
- **Impact of Cross-selling.** As noted above, one often-stated goal of consolidation is to increase the solutions available to clients. However, cross-selling is not without pitfalls. In some cases, cross-selling can trigger prohibited transactions or other regulatory challenges. Furthermore, in an era of lawsuits over data privacy and usage and the rise of the California Consumer Privacy Act, careful review can be beneficial to both a consolidating advisor and their clients.
- **Contract Updating.** While new contractual paper is likely at some point, early updating can help simplify compliance needs by bringing clients to consistent, current agreement paper.

These are just a few of a basic steps to take when dealing with consolidation. For complex merged organizations, the list can be far longer. An advisor can be a key hub in a consolidation – whether for their clients when others consolidate or when they consolidate themselves. **N**

» David N. Levine is a principal with Groom Law Group, Chartered, in Washington, DC.



'Back' Talk

What's holding back financial wellness?

BY NEVIN E. ADAMS, JD

Financial wellness – it remains a hot topic among advisors – but among plan sponsors?

For all the coverage that the subject engenders – and it's considerable in this space – it's not unusual to find awareness gaps among plan sponsors, with perspectives ranging from ignorance to ambivalence to downright skepticism.

About a year ago, the Employee Benefit Research Institute (EBRI) conducted a survey of 250 large employers. At the time, the report claimed that while many employers were interested in offering financial wellness programs to their employees, there didn't appear to be a consensus on the approach.

So, what's changed in the past year? Well, as it turns out, not much.

Once again EBRI surveyed large plan sponsors – this time in June 2019, the online survey of 248 full-time benefits decision-makers from companies with at least 500 employees (17% had more than 10,000). Last year's survey canvassed employers with an "expressed interest in financial wellness initiatives" – and the 2019 version also notes that a "key criterion for participating in the survey was that employer respondents were screened to ensure that had some interest in offering financial wellness initiatives."

And yet, even among a group that would seem to be fertile ground for these programs:

- Only about half report currently offering financial wellness initiatives (about the same as a year ago) – and though 20% say they are actively implementing and 29% interested in doing so – that's also about the same as a year ago.
- Only one in four (23%) have created a score or metric.
- Only a third (32%) have done a financial wellness needs assessment.

Moreover, making a business case to management surged as a challenge for the programs, cited by 42% of respondents from 24% in last year's survey. Little wonder since "Lack of Ability/Data to Quantify Value Added of the Initiatives" was cited as a top challenge by 41% of respondents, compared with 25% a year ago. And then there was "Lack of Staff Resources to Coordinate/Market Benefits" – cited by 43% of respondents, versus 27% in 2018.

Ultimately, there's (still) apparently no real consensus around the definition of financial wellbeing; about a third defined it as (just) having access to assistance and resources that enable good financial decisions, about one in five (21%) defined it as (just) being equipped

to achieve retirement security through planning and savings. Only 3 in 10 defined it as (actually) being comfortable or financially secure overall.

Of course, some of that (apparent) ambivalence might be explained by the reality that 29% of respondents describe their level of concern about employees' financial well-being as "low" (another 49% say they have a "moderate" level of concern).

Or perhaps it's the reality that while two-thirds (68%) of employers said that more than half of their employees were eligible for the financial wellness initiatives provided, only one-third (36%) of employers thought that a majority of their employees would actually make use of the benefits.

In fact, the top two challenges in offering financial wellness benefits were a lack of interest among employees (38%, compared with 43% a year ago), and complexity of the programs. This year the survey took that complexity question and found that while (just) 31% were concerned about the programs being complex for employees that utilize them – most of the concern had to do with complexity for the employer; just over a quarter (27%) cited complexity in implementing programs, and another quarter (25%) cited complexity in choosing the programs. Employers, it seems – even those with a propensity to consider these offerings – (still) find the (potential) complexity daunting.

Don't get me wrong. The logic behind these programs is pretty straightforward; it's about staving off bad financial health, which contributes to (and/or causes) a bevy of workplace woes: stress, which can lead to things like lower productivity; bad health and higher absenteeism; and even a greater inclination toward workplace theft, not to mention deferred retirements by workers who tend to be higher paid and have higher health care costs. It's a here-and-now focus that speaks to the bottom line, even if the modest amount of academic research on the subject still struggles to make a quantifiable case.

But, at least in the EBRI survey results, it seems as though even the most engaged plan sponsors still don't quite get it.

And until they do, they won't. **N**



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Case(s) in Point

Last issue we covered three ERISA cases under review by the U.S. Supreme Court this term – and, in preparation for one of those, the federal government has offered its opinion as to the meaning of “actual” knowledge. Meanwhile, three years after the wave of excessive fee litigation was launched against university 403(b) plans, there have been some decisions, but far more settlements, including the two largest to date – suits involving MIT and Vanderbilt University. Perhaps closer to home, this issue we also cover a lawsuit by an ex-participant who had her 401(k) account plundered in pieces.

PERFORMANCE, MEASUREMENT

Morgan Stanley wins fiduciary breach suit

Morgan Stanley has fended off a participant suit that a federal judge described as “opportunistic Monday-morning quarterbacking on the part of lawyers.”

In *Patterson v. Stanley* (2019 BL 384508, S.D.N.Y., No. 1:16-cv-06568-RJS, 10/7/19), U.S. Circuit Judge Richard J. Sullivan, sitting by designation, granted Morgan Stanley’s motion to dismiss, finding that the plaintiffs in the case lacked standing to bring many of their claims under ERISA, and made “conclusory,” but ultimately unconvincing arguments in other respects.

The \$150 million class action had taken issue with Morgan Stanley’s decision to offer six proprietary funds in its \$60 billion plan that the former participants/now-plaintiffs (Ralph J. Peterson & Terri Lo Sasso) claimed charged fees that were improperly high, and that three of those funds (the Small Cap Fund, the Mid Cap Fund and the Global Real Estate Fund) “performed so poorly that any reasonable fiduciary would have removed them from the array of Plan offerings,” noted Judge Sullivan.

The plaintiffs had also claimed that the plan “improperly included seven poorly performing target-date retirement funds

offered by BlackRock” – that, they alleged, were either poorly performing or “entirely untested” when they were added to the plan. Moreover, the plaintiffs argued that those funds charged “inordinate fees” and underperformed throughout the period in question – but that Morgan Stanley continued to offer those funds “because they were being paid by BlackRock to do so,” commented Sullivan.

Standing Stymied

The Morgan Stanley defendants challenged the suit on several fronts; first, whether these plaintiffs had standing to bring suit regarding the seven funds in which they weren’t invested. Judge Sullivan agreed with the defendants that they lacked standing, since they suffered no injury. Moreover, he also rejected the notion that, as part of a class action, they were similarly situated enough to attain that standing, explaining that, “Plaintiffs’ claims will undoubtedly require a fund-by-fund analysis for all thirteen funds identified...”.

Sullivan also rejected the plaintiffs’ alternative argument that they were, in fact, “individually harmed” because the inclusion of the funds “undermined the plan as a whole” by robbing them of their

“right to choose from superior investment options.” Sullivan noted that they “cite no source in the statute for such a ‘right’ or any other basis for concluding that the derivation of the ‘right to choose from superior options’ is enough to establish standing under ERISA.”

With regard to the claims about the imprudent inclusion of proprietary funds, Judge Sullivan said that the plaintiffs’ theory “boils down to an allegation that Defendants either did not (1) offer Plan participants the opportunity to invest in ‘separate accounts’ (as other Morgan Stanley clients did) that replicated the strategies of the MS Funds, but with reduced fees, or (2) unilaterally discount the fees associated with the MS funds to equal those charged to its separate account clients” – either of which he held “must be dismissed.”

‘Separate’ Account

Oddly, Judge Sullivan seemed to say the development of a specific separate account solution in which the fiduciary has an interest or receives fees would violate ERISA, but that – even if an exemption to that structure were to be found – “nothing in ERISA requires a Plan to offer separate



accounts in lieu of reasonably-priced mutual funds.”

In response to an argument that the Morgan Stanley plan participants were ill served by not receiving the same separate account treatment as that accorded other Morgan Stanley clients, Sullivan noted that nothing in ERISA requires Morgan Stanley to “unilaterally offer Plan participants a discounted fee as to the MS Funds, or to reduce the market-based fees of the MS Funds to equal those charged to the MS Funds to equal those charged to separate account clients simply because those funds are including in an ERISA plan” (though he also acknowledged that nothing prevented them from doing so).

Performance ‘Measurement’

As for continuing to offer the Mid Cap Fund (allegedly imprudent because it underperformed relative to its Russell Midcap Growth Index benchmark and two

“alleged comparators”), Sullivan said the plaintiffs had to “allege non-conclusory factual content raising a plausible inference of misconduct and may not rely on the vantage point of hindsight.” Suffice it to say that Sullivan didn’t find the factual content here (a 2016 prospectus – the year the fund was removed from the plan menu) to be sufficient (if not based on hindsight) – nor did he find the allegations “...of the Fund’s alleged underperformance in average returns as compared to certain benchmark indices or alleged insufficient performance history” the requisite plausible inference.

Moreover, he noted that the benchmark difference alleged – “less than one percentage point” – was “such a small disparity in performance relative to its benchmark does not support the inference that Defendants were imprudent to retain the Mid Cap Fund in the set of Plan offerings.” And – Sullivan notes that the yearly benchmark comparisons “fare no

better.” In fact, he concludes that “... the mere fact that the Mid Cap Fund did not do as well as other options does not give rise to the inference that Defendants’ decision to retain that investment offering was imprudent.”

“Put simply,” Sullivan writes, “the duty of prudence does not compel ERISA fiduciaries to reflexively jettison investment options in favor of the prior year’s top performers. If that were the case, Plan sponsors would be duty-bound to merely follow the industry rankings for the past year’s results, even though past performance is no guarantee of future success. Clearly, no court has ever suggested the existence of such a duty.”

Rather, he cautioned that fiduciaries are to consider all the circumstances at the time a decision is made. He applied a similar analysis to the allegations regarding the Global Real Estate Fund, rejecting those claims as well.

Fees ‘Able’?

Sullivan also challenged the allegations regarding fees, noting that “the facts alleged in the Complaint do not give rise to a plausible inference that the Mid Cap Fund’s fees were so excessive as to reflect a breach of fiduciary duty.” He found that the fee differential between the Mid Cap Fund (0.61%) and the Vanguard Mid Cap Fund (0.08%) is not insignificant, but that the plaintiffs had “failed to properly allege that the passively-managed Vanguard Mid Cap Fund was in fact comparable to the actively-managed Mid-Cap Fund.” And assuming they were comparable, Sullivan said that a fee differential alone is insufficient to demonstrate disloyalty without allegations that the Defendants acted “‘for the purpose’ of providing themselves or others a benefit.” Concluding

are improperly grounded in hindsight.” He also noted that those benchmark comparisons didn’t prove the case, since in some years the fund actually outperformed the funds with which it was compared.

He was similarly unimpressed by the claims regarding fees, finding the comparison with Vanguard’s 2025 fund a “conclusory allegation” of comparability – and determining that, in an event, the fee differential (0.12% versus 0.07%) was “only marginally higher.” Sullivan also failed to see support for claims of imprudence in the Vanguard’s option rated higher by Morningstar than the BlackRock option, nor did he find fault with the decision to go with the BlackRock option even though it was “untested.” Supporting his perception that a prudent process was in place, Sullivan cited the reality that Morgan

with the benefit of hindsight, have zeroed in on the underperformance of certain investment options. More is required, and Plaintiffs came nowhere close to alleging such a case in their Complaint.”

What This Means

Judges are people too, and sometimes even in the impartial application of the law, reasoned (and reasonable) minds can draw different conclusions. On the surface anyway, Judge Sullivan’s rejection of the plaintiff’s standing to bring suit as class representatives regarding funds they weren’t actually invested in, stands in sharp contrast to what a number of courts in other jurisdictions have allowed. He focused on the individual aspects of a defined contribution plan and the injuries

“On the surface anyway, Judge Sullivan’s rejection of the plaintiff’s standing to bring suit as class representatives regarding funds they weren’t actually invested in, stands in sharp contrast to what a number of courts in other jurisdictions have allowed.”

his determination here, he wrote, “Absent other evidence demonstrating some improper motivation, Plaintiffs have failed to plead sufficient facts demonstrating the fiduciaries acted disloyally.”

‘Missed’ Targets

As regards the BlackRock target-date funds, only one remained in contention – the 2025 Trust in which plaintiff Lo Sasso invested. In that Judge Sullivan began his analysis noting the similarities between the claims here and the Mid Cap Fund (underperforming benchmarks and “allegedly comparable alternative investment options”), it shouldn’t be surprising that he found these arguments “conclusory” and “insufficient to state a claim,” noting that “backward-looking contentions regarding underperformance

Stanley ultimately removed the BlackRock fund from the set of plan offerings. “On the whole,” he wrote, “Plaintiffs have failed to plausibly allege that Defendants breached their duty of prudence in connection with their decision to offer, and to continue to offer, the 2025 Trust.”

Judge Sullivan was similarly dismissive of the plaintiffs’ claims of a failure of the duty to monitor, or conducting prohibited transactions in paying investment management fees to itself.

The conclusion of the judgment made Sullivan’s disdain for the arguments presented crystal clear: “Contrary to plaintiffs’ claims, ERISA does not require clairvoyance on the part of plan fiduciaries, nor does it countenance opportunistic Monday-morning quarterbacking on the part of lawyers and plan participants, who,

actually suffered by plaintiffs, rather than the class. Not that, considering his take on the arguments presented, he would likely have concluded otherwise.

The bottom line seems to be that Judge Sullivan felt the arguments were presented in a conclusory manner, almost as though the plaintiffs expected their mere presentation of less-expensive, sometimes better-performing alternatives as sufficient to make the case. That is perhaps to be expected after so many similarly positioned litigation charges over more than a decade.

What’s not made as clear in this decision, but seems worth noting, is that the defendants apparently had a review process in place that appears to have been active and effective.

— Nevin E. Adams, JD

TIME 'SENSITIVE'

Feds weigh in on 'actual knowledge' standard

In a case with huge implications for the impact of plan disclosures on starting the clock on the timing of filing suit in ERISA cases, the federal government says that “actual knowledge” means just that.

In an amicus brief filed with U.S. Supreme Court in October, U.S. Solicitor General Noel J. Francisco and lawyers from the Labor Department have thrown their support (*Intel Corp. Investment Policy Comm. v. Sulyma*, U.S., No. 18-1116, amicus briefs 10/28/19) behind Christopher Sulyma, a former participant in the Intel plan.

In June, the nation’s highest court opted to take on a review (*Intel Corp. Inv. Policy Comm. v. Sulyma*, U.S., No. 18-1116, cert. granted 6/10/19) of a decision^[1] by the U.S. Court of Appeals for the 9th Circuit which said that “...‘actual knowledge’ means something between bare knowledge of the underlying transaction, which would trigger the limitations period before a plaintiff was aware he or she had reason to sue, and actual legal knowledge, which only a lawyer would normally possess.”

More precisely, the issue under consideration is “[w]hether the three-year limitations period in Section 413(2) of the Employee Retirement Income Security Act, which runs from ‘the earliest date on which the plaintiff had actual knowledge of the breach or violation,’ bars suit when all the relevant information was disclosed to the plaintiff by the defendants more than three years before the plaintiff filed the complaint, but the plaintiff chose not to read or could not recall having read the information.”

Case History

The friend of the court (amicus) brief notes that while the plaintiff accessed the NetBenefits website numerous times, he testified that he did not review the fund fact sheets referred to in the summary plan description and posted on the NetBenefits website, that he did not recall receiving or reviewing the summary plan descriptions and that he “was unaware that the monies that [he] had invested through the Intel retirement plans had been invested in hedge funds or private equity” until consulting with counsel before filing suit. Moreover, that while he “recalled reviewing certain periodic account statements,” but those statements said “nothing about investments in private equity or hedge funds,” and that “while he worked at Intel, he had little experience with financial issues, and didn’t know what ‘hedge funds,’ ‘alternative investments,’ and ‘private equity’ were.”

In support of Sulyma’s position, the brief explains that “the court of appeals was correct that the statute ‘means what it says.’” More specifically, the Solicitor General notes that in order to



trigger Section 1113(2), “the plaintiff must have actual knowledge of the breach or violation, not constructive knowledge. That is the plain meaning of the term ‘actual’ in this context: existing in fact, rather than imputed by law.”

With regard to the argument that actual knowledge should be deemed based on the contents of the disclosures that ERISA requires be provided to the plaintiff, even if the plaintiff does not read those disclosures, the Intel defendants had equated that with the doctrine of “willful blindness.” But the Solicitor General said that “willful blindness is not a form of actual knowledge, and it applies only when a person takes deliberate steps to avoid acquiring knowledge.” The brief noted that Intel sought “a conclusive legal presumption that plan participants actually know all the information in the mandatory disclosures made available to them, no matter what,” but that that was “at best a form of constructive knowledge, and constructive knowledge is not enough.

“If other fiduciaries or the Secretary were deemed to have actual knowledge of all the mandatory ERISA disclosures they receive or possess, they could regularly have only three years, rather than six years, to investigate potential misconduct and decide whether to bring a civil action,” the government said.

The Supreme Court will hear arguments in the case on Dec. 4, 2019. It’s just one of three ERISA cases on the Supreme Court’s docket this term (see *Full Court Press*, in our Fall 2019 issue).

— Nevin E. Adams, JD

FOOTNOTES

^[1] The lower court had ruled in favor of the Intel fiduciaries, noting that while the plaintiff was an Intel employee he had access to a number of financial documents, including plan documents, fund facts sheets and summary plan descriptions, which included information about plan asset allocations and an overview of the logic behind the investment strategy. This access gave Sulyma “actual knowledge” of the alleged violations three years before he sued, the court ruled, before being overruled by the appellate court.



Massachusetts
Institute of
Technology

TERMS 'LIMITS'

Schlichter wrangles biggest 403(b) excessive fee settlement to date

The terms of an excessive fee settlement are not only the largest to date – once again, they’re about more than money.

The suit – brought by five employees of Massachusetts Institute of Technology (MIT) and participants in the MIT Supplemental 401(k) Plan – was filed back in August 2016 as one of the first to hit the university 403(b) sector. The suit followed grounds common to this litigation – alleging that the plan fiduciaries made decisions that cost participants more than was prudent. Here, however, there was a different element, and one that has not been made to date.

Specifically that those “excessive” payments to the plan recordkeeper (Fidelity) not only occurred because MIT never engaged in a competitive bidding process for those services – but that this was, in effect, an illicit kickback scheme whereby Fidelity received inflated fees at the expense of the plan’s participants in exchange for: (1) making donations to the MIT endowment, and (2) Fidelity CEO Abigail Johnson’s seat on MIT’s board of trustees (the allegations regarding Johnson’s ties to MIT and the potential influence were rejected by the court in 2017).

Cash Cache

The cash component of the settlement – \$18,100,000 – is the largest to date of the university 403(b) excessive fee suits, and from that amount will be paid:

- \$100,000 to Analytics Consulting LLC to provide notices electronically for those class members for whom a current e-mail address is available and by first-class mail to the current or last known address of all class members for whom there is no current email address;
- \$25,000 each for each of the named plaintiffs in the case; and

- \$6,032,730, as well as reimbursement for costs incurred of no more than \$525,000 for plaintiffs' counsel.

More Than Money

But, as been the case in other 403(b) university suits (notably one involving Vanderbilt University earlier this year), the settlement includes a number of non-monetary components as well, including:

- Annual training for the plan fiduciaries on prudent practices under ERISA, loyal practices under ERISA, and proper decision making in the exclusive best interests of plan participants.
- A request for proposal (RFP) for recordkeeping and administrative services for the plan – to be issued no later than 120 days from the settlement effective date, subject to the following conditions: made to “at least three qualified service providers for administrative and recordkeeping services for the investment options in the Plan, each of which has experience providing recordkeeping and administrative services to plans of similar size and complexity.” The RFP is to solicit recordkeeping services which does not “express fees based on percentage of Plan assets and be on a per-participant basis.”
- Deposit revenue sharing related to plan investments (if any) to the plan trust, and – to the extent not seasonably used to defray lawful plan expenses – be “returned to Plan participants according to a method of allocation approved by Plan fiduciaries and permitted by ERISA no less frequently than on an annual basis.”
- Determine a method of allocating recordkeeping and administrative expenses that the plan fiduciaries determine is “fair, equitable, and appropriate for Plan participants” – separate from the flat fee negotiated with the recordkeeper, and “based on the number of Plan participants.”

Other Terms

Now, during the Settlement Period, the agreement states that MIT and the Plan's fiduciaries “shall continue their

current practice of allowing the Plan's recordkeeper to communicate with current Plan participants (in their capacities as such) only at the direction or with the authorization of Plan officials,” prohibiting “any communications to Plan participants (in their capacities as such) concerning non-Plan products and services (those services include, but are not limited to, Individual Retirement Accounts, life or disability insurance, non-Plan investment products, and wealth management services).” However, the settlement also acknowledges that “the Plan's recordkeeper may address non-Plan products and services in response to a request for information initiated by a Plan participant.”

Once MIT has picked a recordkeeper based on the RFP process, MIT is to provide to plaintiffs' counsel the final bid amounts that were submitted in response to the request for proposal (without identifying the recordkeepers who submitted those bids), shall identify the selected recordkeeper, and shall (if then available) disclose the final agreed-upon contract for recordkeeping services (and if not available to forward within 30 days of execution). The settlement also says that MIT “shall provide Class Counsel the current recordkeeping contract for the Plan, to the extent not previously furnished in discovery,” though all such materials are to be kept confidential.

While they have opted to settle, the MIT defendants “dispute these allegations, deny liability for any alleged fiduciary breach, and contend that the Plan has been managed, operated, and administered at all relevant times in compliance with ERISA and applicable regulations.” That said, “after extensive arm's length negotiations with assistance of a nationally recognized ERISA mediator, the parties reached a settlement that provides meaningful monetary and non-monetary relief to class members.” In light of the litigation risks further prosecution of the actions would inevitably entail,” the settlement requests that the Court: (1) preliminarily approve the proposed settlement, (2) approve the proposed form and method of notice to the Settlement Class; and (3) schedule a hearing at which the Court will consider final approval of the Settlement.

Other Cases

Of the roughly 20 universities that have been sued over the fees and investment options in their retirement plans since 2016, there have been five announced settlements; the largest prior to this was with Vanderbilt University, which in April 2019 announced a \$14,500,000 cash settlement, as well as a long list of process/procedural changes that were also to be monitored over a three-year period, and the most recent was about a month ago with Johns Hopkins, which settled for \$14,000,000, also alongside a number of plan design/procedural changes. In March, Brown University settled for \$3.5 million, as well as “other, structural relief.” In May 2018, the University of Chicago entered into a class action settlement for a \$6.5 million cash payment and changes to the university's \$3 billion plan, while earlier that year Duke University announced a \$10.65 million settlement.

On the other hand, St. Louis-based Washington University, New York University and Northwestern University have thus far prevailed in making their cases in court. The University of Pennsylvania, which in 2017 won at the district court level, in 2019 had that decision partially overturned by an appellate court. The plan fiduciaries' motion for an en banc review of that decision was rebuffed earlier this year.

What This Means

This is the second of these settlements (Vanderbilt being the other) to not only impose specific requirement with regard to the selection of a recordkeeper, but with regard to how that provider quotes its services (per participant, rather than asset-based) – and also with regard to its interactions with participants on matters outside the operation of the plan itself. Thus far, we've only seen that be part of settlement with the Schlichter law firm. But considering how recordkeepers have long aspired to be able to leverage their position with participants to expand the relationship, it will be interesting to see how – or if – these kind of terms take root as part of general practice.

— *Nevin E. Adams, JD*

WITHDRAWAL 'HARDSHIP'

Recordkeeper, plan sponsor charged in 401(k) theft

The apparent “hack” of a 401(k) participant’s account has led to a suit against the plan sponsor, the recordkeeper and the plan trustee/custodian to recover the stolen funds.

The suit claims that in September and October 2016, an unknown person or persons managed to steal plaintiff Naomi Berman’s retirement savings by withdrawing a total of \$99,000 in three separate unauthorized distributions from her account in the Estee Lauder Companies 401(k) Savings Plan. She has filed suit “to remedy the harm caused by the Defendant Lauder Plan fiduciaries’ failures to safeguard the Lauder Plan’s assets.”

What Happened

As it turns out, Berman was a former participant (she left employment at Lauder in March 2006 to become a teacher), but, as many participants do, she opted to leave her balance at Lauder after leaving employment there. By June 30, 2016, her balance there had grown to more than \$90,000.

On Oct. 18, 2016, Berman received a document on Estee Lauder Companies letterhead in the mail confirming a distribution of \$50,000 from the Lauder Plan to a checking account at TD Bank. Then on Oct. 24, she received another transaction confirmation from Lauder – this one for a distribution of \$37,000 from her 401(k) account to a checking account at Suntrust Bank made on Oct. 7. That was followed by the delivery of her Q3 401(k) account statement, which included a withdrawal of \$12,000 that had been distributed on Sept. 29 to an account at Woodforest National Bank.

Now, as you might expect, Berman never requested or authorized any distribution from the Lauder plan, and never had any account at Woodforest National Bank, Suntrust Bank or TD Bank. And, sadly, by the time she got the first distribution notice in the mail, all three distributions had been completed – even though, after receiving the first transaction confirmation, she telephoned the Hewitt Customer Service Center at the number



“While there has certainly been a growing concern about cybersecurity risks, there have also been recent cases where individuals within the sponsoring employer and others where TPA or recordkeeping staff have taken advantage of their access to misappropriate funds.”

provided on the confirmation notice – only to be told that her remaining account balance was \$3,791.

‘After’ Math

According to the suit, between Oct. 24, 2016, and Jan. 2, 2017, Berman made at least 23 calls to Hewitt’s Customer Service Center regarding the unauthorized distributions – and ultimately, the Customer Service Center informed her that it had completed its investigation, no money had been recovered, and that her Lauder Plan account would not be made whole. The suit further claims that while the Customer Service Center said they would investigate the unauthorized distributions, they never provided her with any information regarding that investigation, and that “neither Lauder Inc., nor the Benefits Committee, nor Hewitt contacted Ms. Berman further regarding the unauthorized distributions.”

On or about Oct. 25, 2016, Berman reported the unauthorized distributions to the San Francisco Police Department and the FBI, and placed a fraud alert on her credit file with Equifax. On Nov. 7, 2016, State Street Bank & Trust Co., which served as custodian of the Lauder plan’s assets and provided investment management services to the plan, emailed Berman requesting that she complete an “Affidavit of Forgery” for each unauthorized distribution – but she heard nothing further from them.

Berman says that other than the unauthorized distributions from her Lauder plan account, she did not experience unauthorized activity in any of her financial accounts, and that prior to receiving the Oct. 10 Confirmation of Payment, she had no knowledge of the unauthorized distributions. The suit notes that “none of the Defendants contacted her prior to the distributions to obtain her authorization to make the distributions, and none of the Defendants notified her of the distributions by any means other than the mailed Confirmations of Payment and third-quarter account statement, until she telephoned the customer service center.”

The Parties

In addition to the plan sponsor fiduciaries, the suit claims that the plan’s recordkeeper Hewitt (now Alight) “exercised control over Lauder Plan assets by directing distributions from participants’ accounts, including the unauthorized distributions in this case.” The suit also names State Street Bank & Trust Co. as a defendant. The suit argues that since State Street was compensated for its services by investment management fees paid directly from the Lauder plan and by “‘soft dollar’ commissions,” it was a fiduciary of the plan “in that it exercised authority or

control respecting management or disposition of the Lauder Plan’s assets, it exercised discretionary authority or discretionary control respecting management of the Lauder Plan, it had discretionary authority or discretionary responsibility in the administration of the Lauder Plan, and/or it provided investment advice for a fee or other compensation from the Lauder Plan.”

The suit notes that, “Defendants, and each of them, breached their fiduciary duties of loyalty and prudence by causing or allowing the Lauder Plan to make unauthorized distributions of plan assets; failing to confirm authorization for distributions with the plan participant before making distributions; failing to provide timely notice of distributions to the plan participant by telephone or email; failing to identify and halt suspicious distribution requests, such as requests for multiple distributions to accounts in different banks; failing to establish distribution processes to safeguard Lauder Plan assets against unauthorized withdrawals; failing to monitor other fiduciaries’ distribution processes, protocols, and activities; and related acts and omissions.”

The suit also explains that ERISA §502(c), 29 U.S.C. § 1132(c), provides that any administrator who fails or refuses to comply with a request for any information which such administrator is required by ERISA to furnish to a participant or beneficiary by mailing the material requested to the last known address of the requesting participant or beneficiary within 30 days after such request may in the court’s discretion be personally liable to such participant or beneficiary in the amount of up to \$100 a day from the date of such failure or refusal, and the court may in its discretion order such other relief as it deems proper. It also notes that on March 25, 2019, Berman’s counsel made a written request for Lauder plan documents – and that the Benefits Committee “has failed or refused to provide requested material since April 27, 2019.”

What This Means

At this juncture, there’s no indication of exactly how this allegedly unauthorized access happened. While there has certainly been a growing concern about cybersecurity risks, there have also been recent cases where individuals within the sponsoring employer and others where TPA or recordkeeping staff have taken advantage of their access to misappropriate funds.

What seems clear is that we’re likely to hear more about the need for processes such as two-factor authorization when it comes to transactions such as withdrawals. ^N

— Nevin E. Adams, JD



Polling Places

Target-date funds continue to garner a whole new generation of defaulted contribution flows – and yet, interest in, managed account solutions continues to grow.

MANAGING MANAGED ACCOUNTS

TDFs versus managed accounts

In October, we asked NAPA-Net readers about the balance – and the trends – behind these alternatives.

Despite a plethora of options, the vast majority of target-date fund assets has wound up in the hands of a small number of providers. Meanwhile, as participants and their retirement savings “age,” there is a growing sense that they may not be well served by the convenience and (relative) simplicity of “off the shelf” TDF solutions.

Managing Menus

Most (63%) of this week’s respondents have both TDFs and managed accounts in their fund recommendations. However, more than a quarter (29%) don’t include managed accounts, and the rest don’t include TDFs.

And for most (69%), things haven’t changed over the past two years. Nearly 45% have included both target-date and managed account options in their recommendations, while just over a quarter continue to only offer TDFs. Just over 14% say they are currently downplaying TDFs, and nearly as many (12%) are currently downplaying managed accounts. As one reader explained, “Our plans used to have both TDFs and managed accounts, but we have been turning off access to managed accounts for those plans that we can and new plans coming on with us. We feel that the RK website drives participants to unwittingly choose the managed accounts, when the TDF would do just as well for them at a reduced cost.”

Not surprisingly, perhaps cost comes up as a significant factor in many of the responses this week – though not always

in the same light. For example, one reader explained, “Oftentimes, the managed account is recommended simply because it can be the key to get really good fee reductions. I know that can lead to ‘proprietary issues’ but we do believe that if communicated correctly and monitored appropriately, they can help.”

“Properly designed managed accounts offer a great low cost solution particularly for older employees,” explained another. Another reader commented that they have “Target date in most all plans. Managed account available is 30-40% of plans.”

“I like the managed accounts much better,” explained another. “They adjust for an investors risk tolerance and other financial circumstances.”

However, another reader cautioned, “No compelling evidence that managed accounts are offering a significant improvement from a performance perspective; to be most effective a participant must be engaged enough to provide a lot of data to the provider. That’s counterintuitive for an industry that has spent the last decade installing auto features to overcome inertia (which is a phenomenon that we know exists) among participants. Until that problem is overcome, the additional fees are unjustified.”

“Another factor goes into my choice. It is name recognition. Most everyone has heard of V***, but the managed funds out there are not recognizable.”

“We actually use a balanced fund as QDIA because we don’t like the target-date or managed account options,” explained another.

“I honestly do not see where managed accounts make sense,” explained

another. “These are great on the wealth management side but not sure it makes sense inside retirement plans. Maybe for the select few who have significant balances and desire ‘specialized’ assistance. In my mind, managed accounts should not be static and feel most are not ‘managed’ on a regular basis.”

“Some of my clients have managed account options,” noted another. “That said, I am not a big proponent of managed account options for 95% of plan participants because their accounts are not large enough to reap the benefit, thus the fee is not warranted. In my opinion, the recordkeepers generally do a poor job of communicating the fees and many participants end up in managed accounts unknowing that they are paying fees they didn’t need to pay. Recordkeepers see this as a way to derive additional revenues. I think recordkeepers should charge per head fees for managed account administration instead of an asset-based fee.”

“It really depends on the plan’s demographics, though we rarely recommend managed accounts as either an opt-out or opt-in service due to concerns with engagement metrics and cost,” explained another.

“As managed account fees come down, they have merited more consideration,” noted another, “but there is still not much plan sponsor interest.”

For one reader, anyway, “Managed Accounts are really a recent discussion as so many recordkeepers are pushing them out there and we need to discuss them and the issues with the Committee as an objective and unbiased source.”

Recommendation Trends

Asked to characterize the trend(s) in their recommendations (among those who use both target-date funds and managed accounts):

- 51% - target-date funds primarily as a default
- 14% - allow both at participant option
- 10% - managed accounts as a default
- 6% - allow either, at plan sponsor discretion
- 2% - managed accounts for larger, more sophisticated investors

The rest fell into an “other” category, primarily retaining a target-date fund default, with managed accounts being an option, though the “triggers” for the option varied. “Dynamic QDIA – target date below a specific age, managed accounts above a specific age,” explained one reader. “We typically allow both and help the participant understand their features. We have used managed accounts as the QDIA when there is an older population. We have found managed accounts popular with the highly compensated,” noted another. “Managed accounts for over 50 years of age and large accounts,” said another. “Dynamic

QDIA that uses both at conversion based on age,” offered another.

Managed account skepticism was part of the equation, however. One reader explained, “Given cost concerns & engagement ‘inflation’ with managed account providers, rarely are they an appropriate fit for the QDIA.” Or, as another commented, “Don’t use managed accounts. That’s what we are for!”

Driving ‘Ranges’

As for the factors driving the trends, fees dominated that field, cited by 60% of this week’s respondents, followed by:

- 45% - recordkeeper support/choice
- 35% - plan sponsor preference
- 27% - ability to customize (or lack thereof)

And – not surprisingly, asked to winnow those factors down to the primary driver, respondents pretty much lined up the same factors in the same order:

- 38% - fees
- 14% - recordkeeper support/choice
- 13% - plan sponsor preference
- 6% - ability to customize (or lack thereof)

Reader comments on the subject varied – with performance and participant suitability most frequently cited. Here’s a sampling:

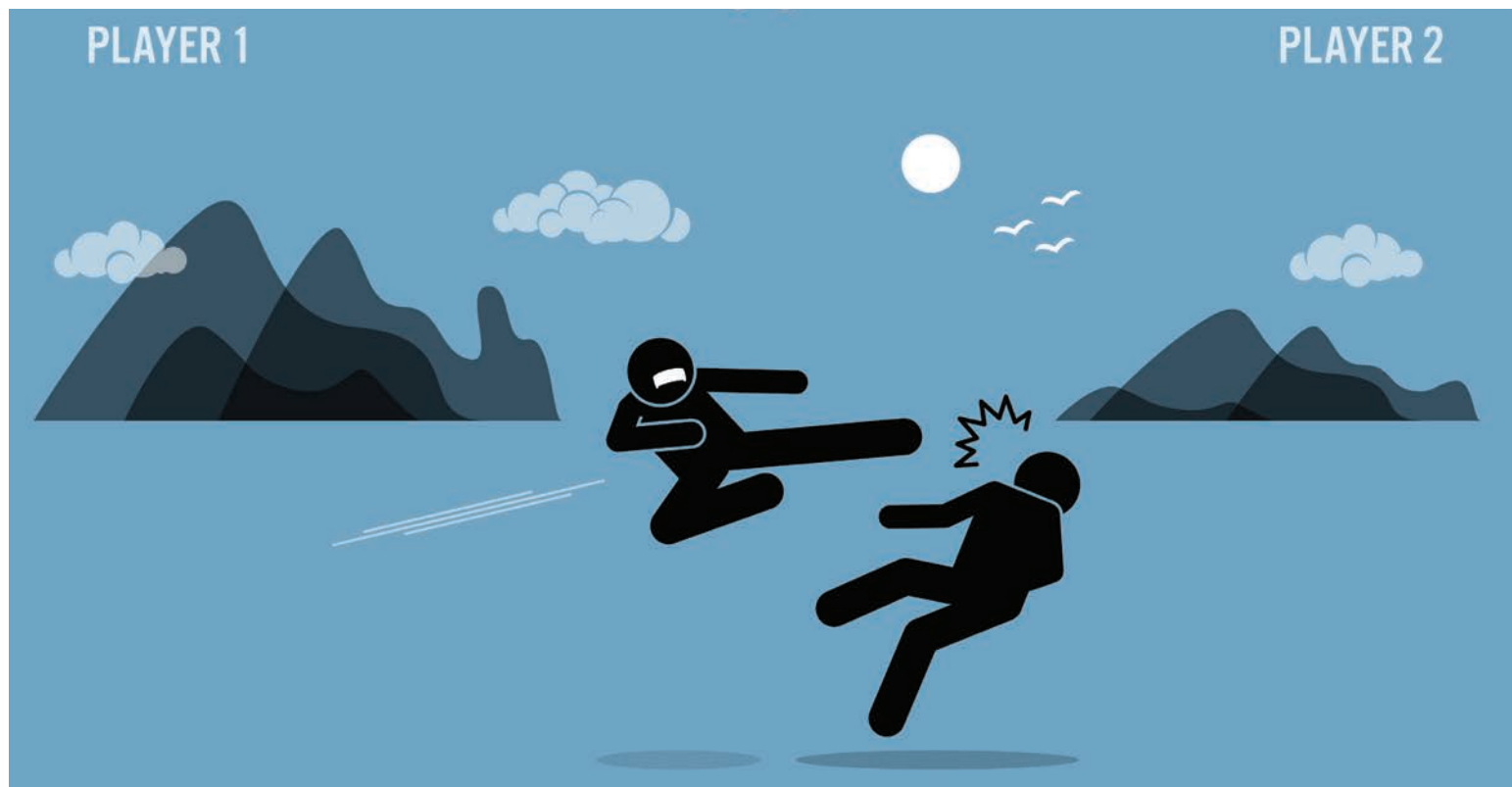
Flexibility of choice based on the participant, and our recommendation to have active money management as an option on the plan at no additional cost to the employer has made us stand out vs the competition.

We watch performance, fees, underlying asset allocation, and style drift. We manage for 3 and 5 year performance.

Best for participants.

Better retirement outcomes. Managed accounts allow for better customization of a portfolio to the individual but it also creates better engagement which leads to better savings rates, better tax optimization, less market impact, etc.

We haven’t been able to put managed accounts into our 401(k) plans. We have however been using and updating annually asset allocation models for participants.



We prefer using a 3(38) managed account solution to minimize fiduciary liability.

Offer participants the maximum number of options.

The active money manager, if doing a great job, helps participants feel more confident knowing someone more knowledgeable is monitoring and making moves in their account when they may not understand the market.

Name brand recognition.

Participants' need for more assistance.

We prefer an open architecture 3(38) managed account that does not have a vendor proprietary fund requirement and one that has some customization available based on risk.

It is all about personalization and the need for advice. Two things that are driving the rest of our economy yet is lacking in the financial services and retirement plan industry. Managed accounts solve this.

Not to be cliché, but whatever is best for plan participants.

Appropriateness relative to the participant demographics and sophistication.

Meeting beneficiary needs, especially protection in the Risk Zone that spans the 5 years before and after retirement.

Managed account providers add a layer of complexity for plan participants that already have limited understanding of what investing is all about.

Feel that plan participants are better off with professional management than with an investment that mindlessly decreases in equity allocation based only on age of the participant.

Other Comments

And yes, we always leave an opportunity for general comments on our weekly reader

poll topic(s) – and yes, we again received a number of interesting perspectives:

Just like TD, not all active money managers are the same either. Match the active money manager's methodologies to the participants you are shopping for or it will become a negative experience for them.

Managed accounts are appealing but the proof is in the pudding... we continue to see them used by the very folks who probably need them the least (younger, lower balance). Our higher balance, more sophisticated participants have continued to provide feedback that it's too simplistic or not as sophisticated as they believe they need for their account balance size and personal situation (e.g., it ain't a financial planner!).

Like financial wellness, the term managed accounts means different things to different people. The devil is in the details. We have built a better solution and believe our plan sponsors and participants will benefit from it.

I am not sold on managed accounts although we have plans that have incorporated them into their line-up. The fee is generally higher and participants do not tend to use them to their full advantage.

Plan sponsor attitudes around managed accounts vary widely. Frankly, much disinformation exist with both options.

I have felt that both have their place in a plan. The vast difference in needs/situations/savings for those 50+ (where I feel managed works well) creates a need for personalization. With the retail world of financial advisors looking to work with clients of higher net worth/investable assets, managed accounts serve a great purpose at a very reasonable fee.

I don't see the point in using managed accounts. People don't even understand TDFs let alone managed accounts. Why pay higher fees for something that you don't understand that won't necessarily bring you better returns?

At the end of the day, there is rarely a fundamental difference in performance (looking backward of course) between TDFs and managed accounts, so why pay even more fees to get similar outcomes?

It's just another way this industry makes investing more complicated and potentially more expensive for the average participant.

In most situations, managed accounts are a way for recordkeepers to generate additional fees. There is very little effort by recordkeepers to really identify participants who have a large enough asset level or complex enough financial situation to benefit from a managed account. In most managed account solutions, there are about the same number of actual portfolio options (8-12) available as there otherwise are available in a normal TDF product. The messaging would suggest a much higher level of customization than actually exists.

Managed accounts are heavily "sold" and rarely does a sponsor have a thorough, sound fiduciary process to evaluate whether they are appropriate for their plan. TDFs have their warts, though rarely does a managed account service that is 5x-10x more expensive than a low-cost TDF make sense for a plan as the QDIA.

Think there could be tremendous opportunity for managed accounts if the fee issue could be ironed out, and some providers are making progress in this regard; fees are much cheaper than they were five years ago.

TDFs look great in a beta market like the one we've had since 2009 but downside management will have its time to shine.

Managed accounts are a superior QDIA if they are face-to-face personal advice, but most managed accounts are robos that defaulted participants really can't use.

Thanks to everyone who participated in this (and every) week's NAPA-Net Reader Poll! **N**

— Nevin E. Adams, JD

The image features a large graphic of a yellow paper airplane at the top, with a trail of white dotted lines leading down to a cluster of many smaller white paper airplanes. These smaller airplanes are arranged in a way that suggests they are all following the path of the larger yellow one. The background is a light blue gradient with faint geometric patterns. At the bottom, there are stylized white clouds.

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Regulatory Review

The fourth quarter brought a lot of change for plan sponsors and advisors alike – most significantly a much-anticipated (and needed) expansion of the safe harbor for electronic participant disclosures, alongside clarity regarding the effective date of certain provisions of the new hardship withdrawal rules. Meanwhile FINRA issued some new guidance of its own – while the industry anxiously awaits the unveiling of a new fiduciary regulation. And the year's not over yet...

ELECTRONIC 'DISCLOSURE'

DOL unveils new E-delivery safe harbor

In a move estimated to save plans and participants \$2.4 billion over the next decade, the Labor Department has unveiled a new, optional, electronic delivery safe harbor for retirement plans.

The Honorable Preston Rutledge, Assistant Secretary of Labor, announced the new proposed safe harbor at the 2019 ASPPA Annual Conference at National Harbor, MD as the rule was posted online.

The proposal – which fulfills a key component of President Trump's August 2018 retirement security Executive Order – would allow plan administrators who satisfy specified conditions to provide participants and beneficiaries with a notice that certain disclosures will be made available on a website.

"Electronic disclosure has been a priority issue in the retirement benefits world for a number of years," said Rutledge. "This step forward – this rule – will provide significant benefits to plan participants, plan sponsors and plan administrators," Rutledge told attendees.

Building on those comments, American Retirement Association CEO and ASPPA Executive Director Brian Graff told Rutledge that "as an organization that has been working with the departments to try and improve and make more sensible disclosure rules for retirement plan participants, we just want to thank you for your leadership" in the matter.

The Proposal

Rutledge explained that rather than sending volumes of paper documents through the mail, plan participants would be notified that information is available online, including instructions for how to access the disclosures and their right to receive paper copies of disclosures. The proposal also includes additional disclosure protections for retirement savers, such as standards for the website where disclosures will be posted and a requirement of system checks for invalid electronic addresses by administrators who choose to rely on the new optional safe harbor.

The DOL notes that the proposed safe harbor would be in addition to the 2002 safe harbor, thus allowing plan sponsors and administrators to choose between the two safe harbors or use both safe harbors, selecting the best approach for their plan population.

Noting that the 2002 safe harbor permits electronic disclosure to workers who affirmatively consent to electronic disclosure or who are using computers as an integral part of their job duties, Rutledge said that, "Stakeholders over the years have raised concern with the effectiveness of the 2002 safe harbor," adding that they have said it's out of date and restrictive, especially the affirmative consent requirement.

"We've heard repeatedly from employers and plan service providers that they can use enhanced technology to improve workers' disclosures. In addition, electronic disclosure can create efficiencies, cost reductions that do not exist when disclosures must be delivered



by mail in paper. So, we recognize that a lot has changed since that safe harbor was issued in 2002,” said Rutledge, continuing, “Today, plan participants want and expect greater access to information electronically.”

In addition, individuals who prefer to receive these disclosures on paper would still be able to request paper copies and to opt out of electronic delivery entirely. Moreover, administrators may not default disclosures to electronic formats without first notifying – by paper – the ability to opt for paper disclosures.

As for the particulars of that electronic address, the proposal acknowledges that in the case of a company-provided email, or a company-issued mobile smartphone (with a data plan) and corresponding mobile phone number could also be used to satisfy this condition. Alternatively, the proposal also allows an employee to provide a different, personal email address to the administrator.

As noted above, the Department expects the proposal to expand use of internet technology to furnish covered disclosures to workers and to result in approximately \$2.4 billion net cost savings over the next 10 years for ERISA-covered retirement plans by eliminating materials, printing and mailing costs associated with furnishing printed disclosures. Appearing onstage with Rutledge, American Retirement Association (ARA) CEO Brian Graff said that he thought that the DOL economists are correct that “we’re talking about billions of dollars that are going to be to the benefit of American workers’ retirement savings.”

Indeed, a report commissioned by the ARA and the Investment Company Institute in 2018 estimated that participants could save more than \$500 million per year, assuming about eight participant mailings per year across more than 80 million 401(k) account holders.

Rutledge further noted that “the

framework in the proposal is similar to the approach the Securities and Exchange Commission has taken for certain investor disclosures and is intended to align with the Internal Revenue Service rules about delivering retirement plan disclosures electronically.”

The DOL’s proposal also contains a Request for Information containing detailed questions about whether and how any additional changes to ERISA’s general disclosure framework are needed, with a focus on design, delivery and content to further improve the effectiveness of the disclosures.

And, consistent with President Trump’s Executive Order, Rutledge explained that the proposal solicits feedback not only on the safe harbor, but on additional ideas beyond that safe harbor to improve not just the delivery, but the effectiveness of the disclosures.

— Ted Godbout and John Iekel

FAULT 'LINES'

FINRA finds fault with suitability supervision at some BDs

FINRA's latest report on its examination findings reveals that some broker-dealer firms still fall short with respect to their supervisory and documentation requirements.

The organization's "2019 Report on Examination Findings and Observations" found that some firms did not have adequate systems of supervision to review whether recommendations were suitable considering a customer's financial situation, investment experience, risk tolerance, time horizon, investment objectives, liquidity needs and other investment profile factors.

The report reflects key findings and observations identified in recent examinations and contains effective practices that could help firms improve

their compliance and risk management programs, including in the areas of supervision, cybersecurity, best execution and segregation of client assets.

In the area of product exchanges, FINRA found that some BDs "did not maintain a supervisory system reasonably designed to assess the suitability of recommendations that customers exchange certain products, such as mutual funds, variable annuities or unit investment trusts (UITs)." FINRA notes that some firms did not maintain blotters or other processes to identify patterns of unsuitable recommendations involving long-term products.

Additionally, firms in some cases did not reasonably supervise exchanges because

they could not verify the information provided by registered representatives in their rationales to justify a recommended exchange, such as inaccurate descriptions of product fees, costs and existing product values.

Red Flags

FINRA also reports that the supervisory systems of some firms "were not reasonably designed or used to detect red flags of possible unsuitable transactions." For example, the organization notes that firms did not identify or question patterns of similar recommendations by representatives or branch offices across many customers with different risk profiles, time horizons and investment objectives.



Moreover, in some instances several customers of a representative or branch office appeared to have made “unsolicited transactions” in identical securities, which could raise questions around whether the transactions were actually “unsolicited,” the report observes.

Insufficient Procedures

Some BDs also did not adequately address newly adopted or amended rules by developing controls to address the new requirements and by updating their written supervisory procedures (WSPs).

As examples, the report points to new fixed income mark-up disclosure requirements; new trusted contact person information requirements; and temporary holds, supervision and record retention requirement. “Firms are expected to evaluate which new and amended laws and regulations apply to their business, and review whether their supervisory systems, WSPs and training programs need to be amended to comply with any new or amended requirements,” the report advises.

Digital Communications

FINRA further notes that it observed firms encountering challenges in complying with supervision and recordkeeping requirements for various digital communications tools and technologies.

In some cases, firms prohibited the use of texting, messaging, social media or collaboration applications for communicating with customers, but did not maintain a process to identify and respond to red flags that representatives were using impermissible communications. “Red flags could be detected through, for example, customer complaints, representatives’ email, outside business activity reviews or advertising reviews,” FINRA notes. Some representatives also conducted “electronic sales seminars” in a chatroom or on digital channels that were not permitted by their firms and were outside of supervision or recordkeeping programs.

To establish effective practices, FINRA notes that some firms maintain governance processes to manage firm decisions and develop compliance processes for each new digital channel, as well as new features of existing channels. “Such firms worked closely with their marketing, compliance and information technology departments, as well as their third-party vendors to monitor the rapidly evolving array of communication methods available to their associated persons and customers,” the report explains.

Cybersecurity

Cybersecurity was another topic of concern. “While many firms have made significant improvements in their cybersecurity programs, cybersecurity attacks continue to increase in both number and level of sophistication,” the report observes. Recognizing that there is “no one-size-fits-all approach,” FINRA recommends that firms evaluate each of the cybersecurity controls described in the report and other FINRA resources in the context of their business model and risk profile.

— Ted Godbout

‘CHECK’ MARKS

FINRA provides Reg BI checklist

In preparation for the June 30, 2020, compliance date for the SEC’s Regulation Best Interest and Form CRS, FINRA has created a checklist to assist member firms in their efforts to comply with those requirements.

The checklist outlines the major requirements of the rules and notes key differences between FINRA rules and SEC’s Reg BI and Form CRS.

The Reg BI section includes a 20-point list addressing everything from updating policies and procedures to identifying and addressing conflicts of interest. Similarly, the Form CRS section includes an eight-point checklist running the gamut from information that must be included on the form to processes and procedures for updating and delivering the form.

The checklist explains, for example, that unlike FINRA’s suitability rule, SEC’s best interest standard explicitly applies to recommendations of types of accounts. “A broker-dealer (BD) or [associated persons] must have a reasonable basis to believe that a recommendation of a securities account type (e.g., brokerage or advisory, or among the types of accounts offered by the firm, including IRAs) is in the retail customer’s best interest at the time of the recommendation and does not place the financial or other interest of the BD or AP ahead of the interest of the retail customer,” the document states.

It further notes that when considering recommendations of types of accounts, consideration should be given to:

- services and products provided in the account;
- projected cost of the account;
- alternative account types available;
- services the retail customer requests; and
- the retail customer’s investment profile.

Adopted by the SEC on June 5, Reg BI establishes a “best interest” standard of conduct for broker-dealers and associated persons when making recommendations to a retail customer of any securities transaction or investment strategy involving securities. The Commission also adopted as part of that regulatory package a new rule to require broker-dealers and investment advisers to provide a brief relationship summary to retail investors, known as Form CRS.

As with other SEC rules, FINRA notes that it will examine for and enforce compliance with Reg BI, adhering to SEC guidance and interpretations. The organization also advises that it plans to review its rules to see whether changes are needed to align with the SEC’s rulemaking.

In addition to the checklist, other resources are available on FINRA’s Reg BI webpage.

— Ted Godbout



EXTENSION 'CHORD'

Good news and a one bad apple update from Treasury's Weiser

Carol Weiser, Benefits Tax Counsel at the Treasury Department, announced some good news about the deadline for amending plans for the newly final hardship withdrawal regulations at the ASPPA Annual Conference on Oct. 22.

Timing of Amendments for Final Hardship Regulations

Appearing at the Government Update general session with the Honorable Preston Rutledge, head of the EBSA, Weiser clarified that the deadline for amending preapproved plans to incorporate the Sept. 23 final rules on hardship distributions is being extended.

The amendments must be made by the due date of the employer's tax return that includes Jan. 1, 2020, she said, even if the amendment is effective before that date. Practitioners had been concerned that if plans changed their hardship withdrawal policies and procedures to follow the Sept. 23 final rules in 2019, they may be faced with an unreasonably short period of time

in which to amend the plan to reflect those new policies and procedures – such as the due date for the 2019 tax return.

Mitigating the One Bad Apple Rule

Turning to the IRS/Treasury proposed rule issued in July on MEPs, Weiser addressed the regulators' efforts to mitigate the adverse impact of the one bad apple rule under Code Section 413. Noting that the tax code has always defined a MEP as a single plan in which multiple employers participate, Weiser added that the regulations under Section 413 apply to each participating employer – and that if one participating employer has an issue with its plan, that has the potential to "taint" the entire MEP.

"There was a concern that this created a disincentive for employers to participate in a MEP, and we were directed to see what we could do to try to mitigate that disincentive – without interfering with the basic principles governing qualified plans," she said. "So the regulations that we

proposed do provide for an opportunity for the administrator of a MEP to take action to deal with an employer that either is not responding to a qualification issue or the administrator knows there is a qualification issue."

The basic fix is that the plan administrator would be able to facilitate a spinoff and a termination of the plan attributable to that employer. But there are a number of conditions that are designed to ensure that this is not a situation in which the plan administrator is acting precipitously. "The proposed regulations specify a number of steps that the plan administrator would have to follow – basically a series of notices that the administrator would have to provide the employer about corrective steps that must be taken," Weiser said. The threshold requirements used in this procedure are based on those under the IRS EPCRS program, she noted – the plan must not be under examination, must have practices and procedures in place to monitor qualification issues, etc.

Comments Received on Proposed Rule

Noting that the comment period on the one bad apple rule closed on Oct. 1, Weiser shared some details about the comments that were received. "We got about 20 comments, and two requests for a hearing," she said, adding that a public hearing has been scheduled for Dec. 11. Characterizing the comments as "helpful" (included those submitted by the ARA), she listed a few of the recommendations that they make:

- Clarify the types of failures that are eligible for relief
- Clarify when a failure is attributable only to the spinoff employer
- Provide some examples
- Shorten the notice period, such as a total of 6 months, not 9 months
- Compress some of the periods, such as 60 days instead of 90 days

"We'll certainly be looking at how we can streamline the process and timeframes," Weiser said. "We want to strike the right balance. And we want to issue final regulations as quickly as we can." ^N

—John Ortman



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An aerial photograph of a two-lane asphalt road that curves through a dense forest. The trees are mostly green, with some showing early autumn colors of yellow and orange. A small red car is visible on the road, traveling away from the viewer. The road has white dashed lines for lane markings.

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