Public Sector Retirement News & Views

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Behavioral Finance: Can Enhanced Active Choice Help Increase Participation?

Deferred compensation programs typically offer open enrollment year-round. Employees can choose to participate when they feel ready and motivated to do so. This traditional enrollment method is known as the "opt-in" approach. However, many employers are moving to an "opt-out" or "enhanced active choice" approach where employees are asked to specifically indicate that they do not want to save for retirement.

How does this work? Consider distributing a memo that describes the benefits of participating in the retirement savings plan and asks employees to choose from a series of options:

- I am already participating and do not need additional information at this time.
- I am already participating and would like an account review with my representative.
- I am not participating, but would like to start and would like the representative to contact me.
- I am not participating and choose not to do so. I understand that I may not have sufficient retirement savings and may have to work longer if I do not participate in this important benefit.

Note that the fourth option helps heighten employees' awareness of the possible consequences of nonparticipation. Wording the option this way and encouraging them to consider one of the other options helps employees avoid regret aversion—the desire to minimize future regret from not participating in the retirement savings plan. The option is worded in such a way that it helps employees reassess their priorities.

Using enhanced active choice and asking employees to actively choose to participate or not is one of the great success stories in increasing participation rates in retirement savings plans. Studies show that programs using enhanced active choice boast as many as 75 percent choosing to participate in the program.[1] If you are interested in discussing this in your plan, please contact your NFP advisor for assistance.

[1]*Journal of Consumer Psychology. Enhanced active choice: A new method to motivate behavior change. October 2011.*

Fiduciary Update

Tax Cuts and Jobs Act: An Update
The House of Representatives submitted its version of the Tax Cuts and Jobs Act to the Senate in November. In the House version, certain provisions of 457(b) and 403(b) plans were proposed for repeal. Under the auspices of plan consolidation, some of the catch-up rules for these plans were at risk; moreover, an earlier version of the bill would have imposed a 10 percent early withdrawal penalty on governmental 457(b) plans. Fortunately, the Senate version amended the bill and these provisions were deleted, thereby maintaining these important provisions for public sector employees.

Following passage of the Senate version, the bill was referred to a conference committee to reconcile the differences between the two versions. Final agreement was reached in late December and left non-qualified defined contribution plans untouched. The act was then forwarded to the president for signature.

Fiduciary Rule Update
The Department of Labor announced in November that implementation of the final Fiduciary Rule was delayed 18 months to July 1, 2019. As expected, no changes were made to the proposed rule, except the due date for implementation.

The primary provision of the Fiduciary Rule that is of interest to public sector plans is the Best Interest Contract Exemption (BICE). This provision would permit firms to use current compensation models as long as they acknowledge their fiduciary status and act accordingly. Also included are the requirements to provide prudent and impartial advice, disclose potential conflicts of interest, disclose information about their revenue models, avoid misleading statements and receive only reasonable compensation. Many in the industry view this delay as an effective repeal of the most critical provisions of the Fiduciary Rule.

During the transition period, providers will be deemed to be in compliance with the Fiduciary Rule by adhering to the impartial conduct standards, which require acting in the best interest of customers

Target Date Funds

Target date funds (TDFs) are an integral part of many deferred compensation programs around the country. They offer many advantages, particularly for participants who are not inclined to actively engage in an investment strategy. One of the greatest advantages is that TDFs are designed to automatically rebalance as the participant gets closer to retirement. Many plan sponsors choose TDFs as the default investment option for their participants.

TDFs offer a long-term investment strategy using a mix of investments that change as the participant ages. The asset allocation strategy moves from a more aggressive, riskier approach in a participant's younger years, to a more conservative, less risky approach nearing retirement. It is important for plan sponsors to know whether their TDFs use a "to retirement" or "through retirement" approach: the "to" approach will reduce equity exposure so that the TDF reaches its most conservative point at the target date; the "through" approach will use a strategy that reaches the most conservative asset allocation much later.

Because TDFs can vary widely in asset allocation strategies and fees, offering TDFs comes with some fiduciary responsibilities. To meet these responsibilities, plan sponsors should:

- Engage in a process to objectively compare and select each fund. This will include an evaluation of the funds' performance, fees and expenses; consideration of how well the TDFs align with plan participants' ages and likely retirement dates; and whether the employer offers a pension plan.
- Establish a periodic review process for the TDFs. In addition to reviewing the funds' performances against their respective benchmarks, plan sponsors should also consider whether there have been any changes in the investment strategy or management team. If any of these elements do not meet established standards, it should be considered for replacement.
- Understand the funds' investments and how they will change over time. Do the funds use a "to" or "through" strategy? Knowing whether your participants are likely to withdraw their accounts at, or periodically throughout, their retirement will help you determine which approach is best for your plan.
- Review the funds' fees and expenses. Small differences in fees and expenses can seriously impact a participant's ability to save long-term. Both the expenses for the TDF and the underlying funds should be considered, and plan sponsors should understand what the TDF fees are paying for—rebalancing, access to special funds or other benefits.
- Review the suitability of proprietary versus custom funds. Some providers offer a pre-packaged series of TDFs, while others may offer custom options. Proprietary funds typically use average participant characteristics to match to a single TDF, managed by a single investment manager. Custom funds will use individual participant savings information to match to multiple TDF options, usually overseen by an investment management team.
- Communicate, communicate, communicate. It is important for your employees to understand how TDFs work, particularly if the TDFs use a "to" or "through" investment strategy.
- Document the TDF selection and review processes. Documenting the decision processes made in selecting funds and other important aspects of your plan is important to show prudence and diligence in your fiduciary role.

With appropriate oversight, TDFs may offer many enhancements to your plan. In addition, offering a TDF as your default fund may help you increase plan participation. Your NFP advisor can help you navigate and manage your responsibilities for these and other funds in your plan.

NFP Governmental Retirement Plan Expertise

Bill Tugaw is the governmental plan practice leader for NFP. He has assisted public sector employers in meeting fiduciary obligations associated with operating their plans for more than 30 years. Bill is a faculty instructor for the International Foundation of Employee Benefit Plans (IFEBP) on public sector 457(b), 401(a) and 403(b) plans. Bill is frequently invited to lecture on employee benefits, post-employment health plan options, requests for disclosure and requests for proposals. Bill is co-author of two books: *Deferred Compensation / Defined Contribution: New Rules / New Game for Public and Private Plans, and Defined Contribution Decisions: The Education Challenge.*

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