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The annual conference for the National Association of Government Defined Contribution Administrators (NAGDCA) was held in Milwaukee, WI from September 24-27. The conference provides an excellent opportunity to learn from key Washington personnel regarding what is happening on the legislative, regulatory and IRS audit front and to also hear from industry experts and peers about their best practices. This issue of *News & Views* summarizes key conference issues and recommendations. Conference presentations are currently on NAGDCA's website (www.nagdca.org). We encourage you to take time to view the presentations.

LESSONS FROM BEHAVIORAL ECONOMICS FOR PUBLIC PENSION PLANS

Everyone has behavioral biases. Many people have a bias for the present over the future, for inattention and for heuristic thinking (stimulating interest as a means of furthering investigation). Retirement planning is complex with different designs offered— defined benefit (DB) versus defined contribution (DC) versus hybrid plans. Additionally, there are supplemental DC plans and pre-tax versus Roth options. Participants are asked to think about how much they need to save which may be demanding too much of participants in terms of their understanding or willingness to invest time to understand these complexities, especially when procrastination is added into the mix.

As a result of these challenges, one can see certain patterns. There is often a direct correlation between the number of funds and participation. The greater the number of funds, the lower the participation. When asset allocation choices are established, it's often easier for participants to evaluate fewer options. They are likely to give more weight to the familiar. Diversification is not automatic, there is a preference for the status quo even when auto enrollment or auto diversification is implemented. Options at the beginning of any list are often more highly selected than those at the end and the size of assets or numbers of participants in any option will many times sway the majority to select that option.

There are solutions to overcoming the many biases participants possess. Plans can make fewer options available and pick a sensible default option. It is important to simplify the enrollment process through the use of easy enrollment strategies or the use of target date funds.

Strategies for plan sponsors to remember:

1. Seek to implement auto enrollment
2. Differentiate default options (including traditional or Roth, DB invested or not)
3. Reduce options
4. Make choices comparable
5. Offer active choice
6. Consolidate and simplify enrollment
7. Exploit existing decision moments (open enrollment, secure retirement week)
8. Encourage a fresh start (new year resolutions, pay increases)
9. Offer frequent reminders
10. Incorporate planning aids
11. Establish a preference checklist

THE NEW WASHINGTON

With the failure of healthcare reform, Congress is pivoting to tax reform for both corporations and individuals. The two primary sources of revenue that Congress is likely to review are: 1) employer-sponsored healthcare and 2) DC plans. With the latter, the term "rothification" is being used to consider whether all or a portion of contributions should be post-tax instead of pre-tax. The Congressional Budget Office estimates that $680 billion are lost through DC pre-tax contributions. Although there is stiff opposition, these tax reforms may be proposed independently or combined with repealing and replacing the Affordable Care Act (ObamaCare). There is also an exploration of numerous other options: 1) whether teachers should be allowed to contribute to both 403(b) and 457(b) plans; 2) whether all defined contribution plans should be combined into a single option; 3) whether catch-up provisions should be eliminated; 4) whether having a 10-year moratorium on annual maximum contributions should be implemented; or 5) whether maximum annual contributions should be divided with $9,000 pre-tax and $9,000 post-tax.

In light of recent fiduciary litigation activities, should non-ERISA plans be concerned? In the 403(b) area, the use of too many providers and too many fund options are the source of primary concern. In 401(k) plans, it is the absence of due processes for selecting, monitoring and replacing funds that represent the most likely area of exposure.

Even though the Department of Labor's Fiduciary Rule was postponed to June 2019, it is unlikely that Congress will overturn this regulation as they would have to do so outside budget reconciliation. There is a similar question about whether rothification can be addressed in budget reconciliation (which only requires 50 percent voting instead of the 60 Senate members for other actions).

ABOVE AND BEYOND: THE LATEST IN MENU INNOVATIONS

North Carolina has nine DB plans with assets of $93 billion and three DC plans—a 457(b) plan with 53,080 participants and $1.3 billion in plan assets, a 401(k) plan with 247,114 participants and $9.2 billion in plan assets and a 403(b) with 1,186 participants and $11 million in plan assets.

The State does not offer self-directed brokerage accounts or managed accounts in their plans. In both 2009 and 2011, the plans began to simplify their investment lineups and reduce fees and seek to leverage both DB and DC assets to further reduce fees. Since then, the plan has sought to over-communicate, minimize jargon, offer town hall meetings and robo-calls to influence behavior. The State implemented a white label approach where funds have a generic name and underlying fund managers are selected by the State. When there are changes to the fund managers, there are no changes to the fund name.

The State seeks to have individuals retire with 80 percent of income at age 62. At present, 62 percent of all employees and 73 percent of employees who also invest in DC options are on track to meet that goal.

Further simplification to the plans were made in 2017 including changing the TDF glidepath from "to" to "through" and re-examining both the process and documentation of the State's actions.

FINANCIAL WELLNESS "TO" AND "THROUGH" RETIREMENT

Many employer survey results indicate that 92 percent are expanding financial wellness programs; one-third of the workforce is 50 or older; and 73 percent are planning for increased healthcare costs due to an aging workforce.

Holistic planning is critical. In addition to any DC assets, the following factors can also be considered: outside assets, income forecasting, and leveraging retirement income/savings to increase Social Security benefits. Employing a naïve Social Security strategy versus a well-planned one could result in a lifetime benefit difference of tens of thousands of dollars. For example, many individuals have it ingrained in them to delay utilizing DC assets as long as possible. However, using some of these assets in order to delay Social Security distributions and, in the process, allowing for the Social Security benefit to increase over time, can result in a greater benefit in the aggregate. Retirees are not using these holistic strategies for several reasons, including human behavior (again, people don't want to touch their defined contribution plan assets); many solutions are just tools / education (they don't drive action); lack of access to financial help due to asset minimums; and high fees (retail advisor fees often range from 0.85 percent to 2 percent or more).

HEALTHCARE UPDATE

Healthcare costs often represent the largest retiree expense. Additionally, healthcare costs are increasing at a rate faster than the CPI (inflation). One 2016 study found that a healthy retiring couple would need $275,000 for out-of-pocket medical expenses over the course of their retirement. Creating awareness around healthcare costs is a critical goal. A retiree needs to ask three questions:

1. How much money do I need?
2. How much money can I withdraw?
3. How long will my money last?

On average, someone needs to hear a message seven times before they take action. That's why constant communication is so important. Healthcare cost calculators can also play an important role.

Five steps participants can take are:

1. Control what they can;
2. Make a ballpark budget;
3. Determine if they'll receive retiree health insurance;
4. Explore health savings options; and
5. Set aside funds in a retirement account.

Participants pay more for healthcare under the following scenarios:

1. If they retire early;
2. As they age; and
3. If they are single.

UNDERSTANDING FEES AND AVOIDING FEE-BASED LITIGATION

There are many different fees presented in DC plans and may include investment management fees, management fees, administrative fees, revenue sharing fees and more. It is imperative that plan sponsors are aware of the various fees charged to either participants or plan sponsors. These fees can be charged as asset-based, dollar-based or a combination of the two. Plan sponsors can develop a written fee policy and monitor the plans regularly for fee compliance.

Fees have generally declined over the past decade and the use of a plan expense reimbursement allowance has increased over the same period. For instance, the use of plan assets to pay for appropriate plan expenses has increased to 58 percent of plans in 2015, up from 20 percent in 2006.

Many, but not all, mutual funds have revenue sharing built into the expense structure of the fund. These revenue sharing arrangements are often called 12b-1 distribution fees, sub-transfer agent fees (sub TA fees), servicing fees and commissions. The most common are 12b-1 and sub-TA fees.

All plans usually have a cost to administer by the plan sponsor and it is considered appropriate for plan assets to pay for appropriate plan expenses. There are various ways to collect funds for these expenses including: 1) using revenue sharing to offset expenses; 2) zero expense revenue investment lineup and an explicit administrative asset charge; and 3) lowest all-in fee approach. With the lowest all-in fee approach, plan sponsors need to make sure that any revenue generated be credited back to the participant invested in the fund.

Fee levelization has become a popular way to equalize the fees paid for plan administration between participants. There are also three methods of fee levelization: 1) revenue rebating where the recordkeeper collects all revenue sharing and periodically rebates it back to the participant invested in the fund; 2) partial revenue offsetting where revenue sharing is collected up to a point. In the event the revenue does not satisfy the plan revenue requirement, the participant invested in the fund will be charged a wrap fee; 3) full revenue offsetting is identical to the partial revenue offsetting with any excess revenue credited back to the participant invested in the fund.

The method by which participants are charged these administrative fees are either an asset based pro-rata charge, a fixed dollar participant charge or a combination of the two. Plan sponsors should consider the pro-rata method so as to not significantly disadvantage participants with lower balances.

The most common types of lawsuits are excessive recordkeeping or investment fees in the lineup. The key themes in most of these lawsuits are requirements in ERISA (which many times are considered best practice), however governmental plans are exempt from this requirement. Duty of loyalty, duty of prudence and prohibited transactions lead the lawsuit themes. The steps to address these lawsuit concerns generally are to follow best practices. While governmental plan sponsors are exempt from ERISA, most state laws address these issues and many have taken language straight from ERISA.

The case study of the Sanitation Districts of Los Angeles County discussed the 457(b) plan with approximately $292 million in assets for the employees and retirees of 24 separate legal districts in 78 cities around the L.A. area. They moved to one provider and an open architecture structure in 1996 and conduct an RFP on the plan every five years. They have an explicit fee disclosure, a quarterly asset-based fee charged with no cap. The portfolio is made up of publicly traded mutual funds with institutional share classes. A year prior to retirement, their provider has a certified financial planner (CFP) meet with them to discuss the features of the plan after they separate from service.

INTERNAL BENCHMARKING FOR CONTINUOUS IMPROVEMENT

External benchmarking helps the plan sponsor identify areas where their plan is behind peers in the industry and sets goals for plan growth and improvement. Internal benchmarking helps plan sponsors measure internal changes over time, and can help determine if the plan sponsor is meeting the goals for plan growth and improvement.

Identifying similar plans will be most useful in external benchmarking. Some of the comparators plan sponsors can use to identify peers will be plan asset size, numbers of participants, optional features offered—such as auto enrollment, loans and self-directed brokerage accounts. Once a plan sponsor's peers are identified, comparisons can be made. Plan sponsors should find the areas where their plan is significantly different from their peer group and they will have a good start for developing goals, strategies and action steps for improvement.

Once strategies are implemented, plan sponsors should evaluate the effectiveness of their efforts. For instance, was an education program developed that was intended to help non-participants understand the benefits of enrolling? If so, plan sponsors should measure overall participation at the beginning and end of the education period to see if participation has increased.

Other areas where plan sponsors may want to benchmark include:

- Participant demographics, e.g., participation by age, gender, ethnicity, department, etc.
- Contribution rates
- Average account balance
- Fees and charges
- Investment diversification

NFP GOVERNMENTAL RETIREMENT PLAN EXPERTISE

Bill Tugaw is the governmental plan practice leader for NFP. He has assisted public sector employers in meeting the 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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