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QUALIFIED DEFAULT INVESTMENT ALTERNATIVE – WHY IS IT IMPORTANT?

The qualified default investment alternative ("QDIA") is arguably the most important investment in a plan's investment menu. By far the most often selected QDIA investment is a target date fund ("TDF"). TDFs are typically the only investment selection that offers unitized professionally managed portfolios that reflect the participants' time horizon today and as they go to and through retirement.

TDFs are tied to the anticipated year of retirement. Retiring in 2035? The 2035 TDF is the easy pick. This portfolio will be professionally managed to become more conservative as a participant approaches retirement. This de-risking is based on an investment "glide path" which contains more aggressive investments during the participant's younger years and utilizes more conservative investments as retirement approaches. Off-the-shelf TDFs, however, can vary widely from one fund house to the next. TDFs with the same maturity (e.g., Target Date 2035) can vary widely in their investment strategies and carry much different risk levels. Since 2010 – during the last global financial crisis – the most conservative TD 2010 funds lost around 10%, while the most aggressive TD 2010 funds lost 51%.

TDF QDIA selection is a very important responsibility for plan fiduciaries. In response to the growing popularity of TDFs, the Department of Labor issued specific guidance regarding TDF selection and monitoring steps that begins with aligning TDFs and participant characteristics. The DOL indicated that if the TDF suite has been prudently selected and is commensurate with the plan's participant demographics, the suite meets certain structure requirements, and fiduciary liability mitigation would be available. Prudent process entails identifying your participant demographic needs, and whether they tend towards a low-risk portfolio (e.g., participants are on track for a satisfactory retirement), or perhaps a more aggressively positioned portfolio (e.g., less savings so the need to obtain higher returns), or perhaps a multiple glidepath approach for a financially non-homogenous population. Prudence of TDF selection is also determined by cost relative to other TDFs with similar risk levels, as well as the quality of underlying investments.

Prudently aligning TDF and participant characteristics requires a multi-step process that begins with determining a "best fit" TDF risk profile for a plan. Participant assumptions regarding other retirement income sources, savings rates, account balances, risk tolerance and withdrawal patterns are used to determine whether a conservative, moderate or aggressive TDF risk posture is appropriate for a plan's participant population. A TDFs equity exposure and the rate of change in its equity exposure as participants approach retirement is used to categorize a TDF's risk posture. TDFs with risk postures that match a plan's "best fit" risk profile are further evaluated based upon qualitative factors, performance-related factors and TDF fees.

NFP investment advisors are equipped to run an analysis of the TDF suites in client plans to determine if they meet the "best fit" guidance issued by the DOL. If you would like to discuss Target Date Funds options that will align with the DOL's guidance and are best suited for your plan's participants, please contact your NFP investment adviser.

WASHINGTON REPORT

Secure 2.0 – Where Are We Now?

In our last issue[1] of News & Views, we reported that the House of Representatives overwhelmingly passed the Securing a Strong Retirement Act of 2022, with a vote of 414-5. Following House approval, the bill was forwarded to Senate Finance, where their bipartisan committee was already working on similar proposals.

As a reminder, noteworthy proposed improvements to public sector retirement savings plans include phasing in a change to the age for Required Minimum Distributions to age 75, up from age 72; adding an additional level of catch up for savers over age 60; and elimination of the first of the month rule for 457(b) plans. Senate Finance is expected to include popular provisions from earlier retirement bills in their consideration of the legislation. There continues to be strong bipartisan support for the proposals, and there may be an added impetus for passing legislation this year as many long-term retirement champions are retiring at the end of the year.

NFP will continue to monitor the progress of these proposals and inform clients of the status as it evolves.

Hughes v. Northwestern University – a case study in the importance of managing your fiduciary responsibilities

The Supreme Court recently found in favor of participants in two defined contribution plans offered by Northwestern University, who was determined to have breached their fiduciary duties. Specifically, the Court found that Northwestern had:

- Failed to monitor and control recordkeeping fees, resulting in plan participants paying unreasonably high fees;
- Offered investment options of retail share classes, carrying higher fees than identical investments available to the plan in other share classes with lower fees; and
- Offering too many investment options, which has been shown to confuse investors and result in poor retirement financial planning and behavior.

In the past year, over 100 similar cases of fiduciary breach have been filed, and Hughes v. Northwestern may encourage even more filings. Plan fiduciaries can learn from this case and take action to address their responsibilities, limit their risk of fiduciary liability, and help participants have better retirement savings options.

Plan sponsors are advised to actively identify plan fiduciaries and formalize their duties and authorities to the plan. In addition, fiduciary training should be provided, and plans are advised to hire investment experts to aid in the process of selecting investments to be offered to participants. Options for the investment menu should be carefully evaluated, limited in number, and monitored, ideally under the leadership of a qualified investment advisor. The greater the number of options, the greater the workload/cost to monitor, which adds to the argument to limit choices. Fees should be included in the evaluation and monitoring of all investments offered in the plan. Investment and other significant plan decisions should be made by the fiduciaries after careful consideration and documented in meeting minutes.

Your NFP Advisor can help you identify if you have any gaps in meeting your fiduciary responsibilities and offer advice on steps you can put in place to minimize the risk of fiduciary breach to your plan. Please do not hesitate to engage your advisor in such a discussion.

IRS Issues Proposed Regulations to Update Mortality Tables for Pension Plans

The IRS recently released proposed regulations in May, to update the mortality tables under Code Section 430. The regulations are proposed to be effective for plan years beginning in 2023.

The mortality tables, while primarily used for pension plans, are also important for defined contribution plans. They are used to determine the Required Minimum Distribution (RMD) amounts participants are required to withdraw from their accounts. Tables must be updated at least every 10 years to incorporate the actual mortality experience of plan participants and projected future trends in life expectancy. The existing mortality tables were issued in 2017, but the IRS has provided annual mortality improvement scales that reflect adjustments based on recent and projected mortality experience. The proposed mortality tables are based on mortality experience from 2013 to 2019, and do not consider actual experience related to the COVID-19 pandemic.

Plan sponsors are advised to consult with their recordkeeper to discuss the potential impact to plan participants, and review how RMDs are calculated and participants are notified. Your NFP consultant can also provide additional guidance.

Inflation Expected to Impact Annual Contribution Limits – In a Big Way

Defined contribution limits are set every year, using a formula that incorporates changes in the Consumer Price Index and inflation. The new limits are calculated following the end of the federal fiscal year, which ends September 30. With inflation being at its highest in 40 years, industry experts are predicting contribution limits increasing higher than ever before. The current contribution limit for 401(k), 403(b) and 457 plan elective deferrals is $20,500, and early estimated indicate that the limit could be raised to as much as $22,000 in 2023. The IRS typically determines the new limits in October of each year.

HOW'S YOUR PLAN DOING?

As a plan sponsor, you are likely looking at various plan metrics and evaluating how well your plan is performing. You may be asking your provider and/or adviser to report employee participation rates, average contribution rates, and investment diversification figures (e.g., average number of funds utilized by participants), and comparing this data with comparable industry averages. When you find metrics that are below expectations, what to do? Are there other ways to measure your plan's success and value to your participants? What are your plan's objectives and desired outcomes?

Identifying your objectives and outcomes for plan success is the first step. Likely, you have multiple objectives, which may include attracting and retaining talented employees, and your employees having a high overall degree of retirement readiness. You may also have plan administration goals, such as addressing your fiduciary responsibilities and ensuring your plan is in compliance with applicable regulations. It is essential that all interested parties – the plan's oversight body, plan fiduciaries, and industry partners – understand and agree to the objectives, so that strong measurement tools can be defined and evaluated.

Designing specific measurements is key in determining the success of your plan objectives and knowing your progress towards your desired outcomes. Identifying measurement strategies that can influence outcomes is important, and plan design and participant communication are two common tools. If an objective is to increase employee participation by 10% - what strategies can be deployed to encourage participation? Perhaps certain departments have more under-participation than others; if that is the case, an educational program targeting those areas of the organization could be deployed.

Plan participation rates, deferral rates and diversification are the most common measurements used by plan sponsors in evaluating their plan's success. Digging into these measurements a bit further may help you develop specific strategies. For example, if an objective is to increase the average deferral rate, consider breaking the average down by age group and developing outreach strategies to those age groups with the lower deferral rates. To evaluate participant diversification, ask your provider to give you a report showing the average number of funds utilized by participants.

In addition to diversification, participation and deferral rates, another excellent measurement is the participant rate of return. Many providers include this on participant statements, but it is not always measured against anything. Consider asking your provider to report the percentage of participants managing their own investments (so, exclude managed account and TDF usage from the report) who have an individual rate of return that meets or exceeds the plan's QDIA. (Providers may need to break this down by age group, so they can provide measurements against the proper QDIA / TDF.) For those participants who have lower rates of return than the QDIA, you can ask your provider to reach out to them individually. Further, employee communication can be developed suggesting participants compare their individual rate of return against their age-appropriate TDF – sometimes identifying the proper comparative data point to the participant will help them evaluate if their returns are on track or if they should seek assistance from their representative.

Retirement readiness is difficult to measure, as it does not include all elements of a participant's retirement financial picture. However, this should not stop plan sponsors from considering plan-related strategies that will lend themselves to improving participant behavior and becoming closer to a financially secure retirement. The measurements described in this article, while not solely indicative of retirement readiness, are solid and oft-used tools to help plan sponsors identify plan improvement opportunities. A plan that a) regularly employs key strategies to support agreed-upon objectives and desired outcomes; b) measures the impact of various outreach and communication efforts on plan metrics; and c) creatively develop new strategies to work towards continuous plan-level quality improvement, is a benefit that will help an organization attract and retain talented employees, who will have many opportunities to build a financially secure retirement.

Your NFP advisor is available to help you identify plan objectives, desired outcomes, strategies for outreach and communication, and measurements to help you evaluate your plan's overall success.

NFP GOVERNMENTAL RETIREMENT PLAN EXPERTISE

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1. https://blog.rpag.com/hubfs/Q2%2022%20News%20and%20Views%20220405%20NFP-A.pdf