TOP PRIORITIES FOR DC PLAN SPONSORS MOVING INTO 2017

In a world where change is a constant, it's important to retain vigilance over your defined contribution (DC) plans. However strong your governance structure is, all plans need to evolve with changes in legislation, regulations, industry trends and the changing needs of individuals. What may have been ideal three or five years ago may not be as ideal today.

With this in mind, we encourage DC plan fiduciaries to consider the following as we move into 2017.

1

ARE YOU TAKING ALL COMPONENTS OF AN INDIVIDUAL'S FINANCIAL NEEDS INTO ACCOUNT BEYOND JUST RETIREMENT?

For many individuals, dealing with immediate needs is more critical than making extra retirement contributions, so any retirement savings approach should be cognizant of that. Even actions that appear detrimental in the long term to retirement savings may be appropriate given short-term alternatives. Hence, guidance and tools are necessary to empower individuals to cost-effectively manage their broader financial situations.

It is important to bear in mind that there is more to retirement savings than just having resources for retirement. Retirement savings can play a key role either as a source of funds in times of extreme hardship or as an incentive in relation to, say, student debt, which gives people comfort and confidence in making decisions to save for retirement.

2

DO EMPLOYEE STUDENT LOAN REPAYMENTS HAVE A PLACE WITHIN YOUR DESIGN IN ADDITION TO MATCHING EMPLOYEE RETIREMENT CONTRIBUTIONS?

Forty million Americans currently hold $1.3 trillion in student loan debt, which many are struggling to repay.[1] For many Americans, paying back their student loans is more of a concern than saving for retirement. Yet, if they focus on their student loans, they miss out on their employers' 401(k) match.

Although there are complications with integrating employee student loan repayments within your 401(k) plan design, they can be addressed. Would this assist in making your 401(k) plan more appreciated by your employees?

[1] The Office of Federal Student Aid, Q4 2015 Statistics.

3

WHAT SIGNALS DOES YOUR CONTRIBUTION AND MATCHING DESIGN SEND ABOUT SAVING? SHOULD YOU EXTEND YOUR MATCH? DO YOU REALLY NEED A SAFE HARBOR IF YOU'RE USING AUTO-ENROLLMENT?

One record-keeper reported that if a company offers three contribution choices to a participant in a simplified enrollment process, the most popular will always be the lowest contribution choice irrespective of what that number is. Whether or not you agree with this finding, what messages is your design sending to your participants? By matching up to, say, 4%, are you suggesting to participants that achieving the full match at 4% will be enough to save for retirement?

Look at the behavior of your participants and assess whether your design is influencing the choices being made. Assess whether these are the correct influences. How could the design be more effectively structured to influence the preferred behavior?

4

IS YOUR EXISTING MANAGED ACCOUNT PROGRAM SUITED TO YOUR PLAN, PARTICULARLY IN LIGHT OF THE NEW FIDUCIARY RULE?

Is it clear why you selected the managed account provider you have in place? Or was it simply because that was the option offered by your record-keeper? Could you defend the choice if questioned by participants?

With the impending implementation of the Department of Labor (DOL) Fiduciary Rule, plan sponsors should fully understand exactly what fiduciary role the managed account provider will be accepting. Understanding potential conflicts of interest and what type of advice the managed account provider will provide (particularly related to distributions) will also be crucial for plan sponsors.

5

HOW APPROPRIATE IS YOUR TARGET DATE FUND FOR YOUR PLAN AND ITS PARTICIPANTS?

When the DOL issued "Target Date Retirement Funds — Tips for ERISA Plan Fiduciaries,"[2] it stated that "You should consider how well the TDF [target date fund]'s characteristics align with eligible employees' ages and likely retirement dates." Have you done this? Even if you had, has your participant group changed? Is your target date fund still a high-quality offering? A lot has changed in the past five years. What may have been "best in class" may not be so today.

If you are offering a custom target date fund, have you looked at ways to improve risk-return efficiency? Multi-asset-class idiosyncratic funds are an example of a cost-effective way to increase diversification and improve the efficiency of a target date fund.

[2] http://www.dol.gov/ebsa/newsroom/fsTDF.html

6

DO YOU UNDERSTAND THE UNIQUE NEEDS OF YOUR PARTICIPANTS (AND NONPARTICIPANTS)?

A common theme is ensuring your design is appropriate for your participant base. Participant analytical techniques have significantly evolved, so consider all of the following:

- Perform a cluster analysis — to understand the variety of segments within your participant base.
- Assess participants' financial courage (this has a big impact on the effectiveness of education-type initiatives).
- Consider how participants are using existing investment options.
- Assess participants' relative retirement preparedness.

Analyze nonparticipants as well; maybe it will help you understand what you need to do to get them participating (typically, if you rely on your record-keeper, the nonparticipants will get ignored).

7

SHOULD YOU DELEGATE YOUR FIDUCIARY RESPONSIBILITIES?

We all live in a world where time is precious and we all have increasing demands on our time. With this as a backdrop, what is in the best interests of the plan and its participants?

- Which responsibilities should you as the sponsor keep?
- Which responsibilities would be better served by delegating to a third party?

8

ARE YOU ADEQUATELY MANAGING CYBERSECURITY RISK?

Cyber experts say that it is not a question of if you will have a cyberattack; rather, it is a question of when. In the same way that plan sponsors have policies and procedures in place regarding investments, conflicts and plan expenses, a strategy to address and mitigate cybersecurity risks is recommended.

9

IS IT TIME TO CONSIDER (RECONSIDER) RETIREMENT INCOME OPTIONS?

We are seeing an increasing number of retirement plan sponsors opening up to the idea of retirees taking partial withdrawals from the 401(k) plan.

In addition, the Retirement Enhancement and Savings Act of 2016 includes a number of retirement-income-relevant provisions:

- Provide a much-waited-for safe harbor for the selection of an annuity provider:
  - Provide greater specificity on measures a fiduciary should take.
  - Allow reliance on an insurer's representations related to state insurance status and requirements.
- Require DC plan sponsors to annually provide participants with estimated annuity income generated from plan balance, based on DOL assumptions and guidance.
- Allow greater portability for "lifetime income investments."

Given these developments, we expect more retirement income conversations to take place.

10

HAVE YOU CONSIDERED THE IMPACT OF THE DOL FIDUCIARY RULE?

The recent election result has raised questions as to whether the DOL Fiduciary Rule could be repealed, but, as things stand, key provisions will be in place effective April 10, 2017. Already, we are seeing financial institutions changing their advice services in light of the rule.

As 2017 unfolds, it will be important to understand:

- Whether the DOL Fiduciary Rule will roll out as initially anticipated
- The impact the rule has on you as a plan sponsor
- How your vendors (including your record-keeper) are changing their services to accommodate the rule

Very possibly, the service you initially selected a vendor for may now be quite different, or the vendor's competitors may have changed. With so many changes, should that vendor be reassessed?

11

IS THE INVESTMENT FEE STRUCTURE APPROPRIATE?

We believe the fee focus may have gone too far and that a focus on fees alone is inappropriate; we believe the key is whether the additional expected benefits outweigh the additional fees incurred.

However, for a specific investment strategy, it is in the best interests of participants to pay the lowest fees possible. Investment managers are continually adding new share classes or introducing collective investment trusts, so it is important to establish a process to continually review the investment vehicle you are using to see whether it is the most efficient.[3]

[3] It is worth noting that there has been litigation focused on plan sponsors allegedly failing to switch to lower-cost share classes timeously.

CONTACTS

Amy Reynolds
+1 804 344 2639
amy.reynolds@mercer.com

Liana Magner
+1 617 747 9477
liana.magner@mercer.com

Neil Lloyd
+1 778 558 6334
neil.lloyd@mercer.com

Download a guide on key index definitions.