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401(k) Today

What is the Real Purpose of a 401(k)?

Jeremy Bok

Most plan sponsors, as well as participants, think of 401(k) plans as a tax advantaged savings vehicle. Lately, however, we are hearing more talk about the concept of "Retirement Income" with regard to 401(k) plans. Retirement planning tools are starting to emphasize income replacement and not just account balances. A recent bulletin from the offices of Reish & Reicher entitled "401(k) Account Balances as Monthly Retirement Income" addressed this fundamental shift in the purpose of a 401(k) plan. While historically participant statements have been the resource to show an account balance, statements in the future may be expanded to show what level of monthly retirement income their balance could potentially purchase. At the end of one's career, participants need a "paycheck" to pay their monthly expenses which may include rent, mortgage, automobile, utilities, food, clothing, etc. Not only does that paycheck need to adequately satisfy those expenses, but it also shouldn't run out.

As future retirees, we ask a lot of our 401(k) plans. A typical participant will plan to retire at about age 65. This means that the accumulation phase of the 401(k) should have taken place over about 40 years, from age 25 to 65. But remember that during the distribution phase, a married participant would likely have at least one spouse who will live to see the age of 95. Which means that 40 years worth of contributions, plus earnings, needs to provide income for perhaps 30 years or longer!

In our conversations with participants, we find that few of them have considered much beyond what their balance is today. They often don't see the plan as a savings vehicle to provide income and more importantly, that they may not outlive what it can realistically provide. Sustainable withdrawal programs are typically in the 4-5% range, although market conditions and investments can impact that as well. Thus for every $100,000 that a participant may have accumulated in their account, the amount of income may only be about $4,000 to $5,000 per year, or about $333 to $417 per month. It's the income amount that truly impacts the participant's behavior. The answer to the question of what their true retirement income will be may lead to increased contributions (including catch-up), a change in their retirement/withdrawal date, or even the need for a part-time job.

The Department of Labor and Treasury are requesting more information on the topic of retirement income. The method of reporting this information within a participant statement, if required, will be complex due to the types of assumptions that will need to be made. Look for more on this topic in future newsletters as it develops.

401(k) Market Intelligence: How Does Your Plan Compare?

Many plans sponsors want to know how their retirement plan stacks up to typical plan. Following is a brief compilation of statistics from a variety of industry sources to help you see how your plan compares.

- 60.3% of plans offer immediate eligibility (defined as one month or less of service)
- 39.5% of plans provide immediate vesting for matching contributions
- The most common match formula is $.50 per $1.00 up to 6% of pay (51.8% of all plans)
- 38.4% of plans have an automatic enrollment feature
- 72% of plan sponsors use a life-cycle or target date fund (TDF) as the default option [*The target date is the date of expected withdrawals at retirement; the fund is not guaranteed at the target date or any other time. These funds are subject to risk, including the loss of principal.]
- Plans offer an average of 18 funds for both participant and company contributions
- Company contributions average 2.1% of payroll

- 33% of plan sponsors have no investment committee, though it varies heavily by plan size
- 90% of all plans have a written investment policy statement
- 66.7% of companies retain an independent investment advisor to assist with fiduciary responsibilities
- Investment advice is offered in 60.1% of plans; 21.6% of participants used advice when it was offered
- 41.3% of plans allow participants to make Roth after-tax contributions
- Self directed brokerage accounts are offered in 15.5% of plans
- 61% of plans offer a loan provision to participants (and is more commonly associated with large plans)
- Hardship withdrawals are permitted in 85.6% of plans
- 34.2% of plans have a Safe Harbor plan design in lieu of ADP/ACP testing

ERISA Fidelity Bond versus Fiduciary Liability Insurance

Plan sponsors often ask, "Is an ERISA fidelity bond the same thing as fiduciary liability insurance?" The answer is no, they are not the same. The two insure different people and have different requirements under the terms of ERISA.

An ERISA fidelity bond is required under ERISA Sec. 412. Its purpose is to protect the plan, and therefore the participants. It does this by ensuring that every fiduciary of an employee benefit plan, and every person who handles funds or other property of the plan, be bonded. This protects the plan from risk of loss due to fraud or dishonesty on the part of the bonded individuals. The amount of the fidelity bond is 10% of the plan assets (with a $1,000 minimum) and is capped at $500,000 (or $1,000,000 for plans with company stock).

Fiduciary liability insurance protects the fiduciaries (not the plan or participants) from a breach of their fiduciary responsibilities with respect to the plan. Remember that fiduciaries may be held personally liable for losses incurred by a plan as a result of their fiduciary failures. Unlike a fidelity bond, fiduciary liability insurance is not required under ERISA. The Department of Labor may ask whether the plan fiduciaries have insurance in the event of an investigation. It's important that fiduciary liability insurance explicitly covers "ERISA" claims. And review of any policy, including E&O policies, should look for language that may void the coverage in the event a plan has ever been out of compliance (something virtually all plans experience at some point in their existence).

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