What Is Success?

To be more specific, what is success when managing a retirement plan?

By Paul Powell

Success is typically considered reaching a goal. One of the definitions of success is the accomplishment of an aim or purpose. So what is retirement plan success? What do your organization, your committee, and even you individually consider as success when it comes to managing a plan that directly impacts your organization's finances, your committee's personal liability, and ultimately your employees' ability to retire? This leads to the question of whether you can achieve success without a goal. Without an aim or purpose, what is there to accomplish?

"If it ain't broke, don't fix it."

Some plan sponsors deem the plan a success if there are no significant issues within the plan. Plan sponsors adopting this approach typically have no stated goals and no agreed upon measure of success. Timely deferrals, passing the testing, and no employee complaints typically define this approach. While this may sound extreme, it is common. Unfortunately, this thinking by the plan sponsor has serious deficiencies. First, this approach may leave the committee and board members exposed due to lack of consideration of fiduciary responsibility and liability. Without a consistent and thorough benchmarking process, participants and the organization may overpay for services, which is a breach of fiduciary responsibility. Relying on the provider's investment information alone may lead to a concentration in proprietary funds. In February 2013, the Department of Labor addressed this in its publication, "Target Date Retirement Funds — Tips for ERISA Plan Fiduciaries." Second, plan design and services may not adequately address participants' needs and in some cases may actually work against participants' ability to retire. While the plan may be "working," it may not be successful.

Industry trends, provider technology, and the application of behavioral economics all move the focus of retirement plan success toward participant outcomes. Consider that if the plan "works," fiduciary responsibilities are carried out and documented, the plan passes testing and Department of Labor or Internal Revenue Service audits, and few participants complain. However, if participants are invested inappropriately for their age, deferring at inadequate levels for retirement and completely unengaged with the plan, who has benefited? The participants clearly have not benefited because they will likely arrive at retirement with potentially poor and devastating results. What about the company? What about the money that was invested in a company match or a profit sharing plan? What about all the time and energy invested by the various individuals in Human Resources and Finance departments? Was this capital invested to achieve a return, or did it become another line item on the P&L? Organizations that settle for the "it's not broken" approach to success not only lose the return on the investment but also lose an opportunity to build value in employee ranks. They also risk workers over age 70 having no intention of leaving their position at the organization because they lack the ability to retire. We have all heard the saying, "I'll just work until I die."

Three Steps to Retirement Plan Success

It is not necessarily incumbent upon you to set an organizational goal for your retirement plan program of an 85 percent income replacement for your participants, although that goal has strategic benefits. Instead, at a minimum, every plan sponsor needs to adopt three steps, which if thoughtfully worked through will help any organization achieve goals of retirement plan success. While these three steps are straightforward, they do require a willingness to ask questions and have discussions that the retirement plan committee or the organization may not have had in the past.

There are two rules that create boundaries for this process of success.

First, the process and decisions must fit within the confines of ERISA. Second, the decisions should be made in a research-based systematic approach. ERISA's responsibilities of loyalty, prudence, and reasonableness provide an overarching umbrella for this process.

There are essentially five categories, or topics, of retirement plan management that should be addressed by every retirement plan sponsor. They are plan design, provider management, investment offerings, fiduciary responsibility, and ultimately participant outcomes. I have narrowed these to three steps that, if addressed, will provide the framework for an organization's retirement plan success. I removed fiduciary responsibility as a step because fiduciary responsibility addresses how an employer carries out its duties. As stated earlier, a research-driven fiduciary approach should be the foundation of this process. I also removed participant outcomes because outcomes will be a function of services provided and plan design. Therefore, the remaining three steps for retirement plan success are Goal-Driven Plan Design, Provider and Advisor Value, and a Participant-Driven Investment Menu.

Step 1: Goal-Driven Plan Design

Stephen Covey made the term "begin with the end in mind" famous in his book, *The Seven Habits of Highly Effective People*. This term is fitting for the beginning of many endeavors, including defining success for a retirement plan program. The plan's design will have a large — and some would argue the largest — impact on your participants' ability to retire as well as on your company's expenditures. Inefficient plan design can result in wasted resources and poor participant outcomes. In contrast, goal-driven plan design considers your corporate culture as well as your corporate budget. Therefore, this is the question that must be asked: What is your organizations' goal for the plan? Recruitment? Retention? A moral obligation to provide for employees? Declining efficiencies and the need for older participants to retire? Answering the question about the goal for the plan will undoubtedly take more than a few minutes to answer and will likely require input from many constituents in the organization. However, once you know the answer, you are indeed on the road to success. Eligibility, vesting, the adoption of automatic features, and the default deferral rate, along with the match formula (if offered) can all be derived from answering the question about the plan's goal.

Step 2: Provider and Advisor Value

If choosing the least expensive option was the goal in life, everyone would be driving a Yugo. This conveys the point that cheap is not the goal; value is the goal. The 408(b)(2) regulations were beneficial in helping plan sponsors begin to understand the underlying costs of corporate retirement plans as well as where the revenue collected from participants is spent. Unfortunately, this brought a sharp focus on fees without the corresponding balance of services. Organizations should consider the following definition of value with regard to both their provider (recordkeeper, third-party administrator) and advisor. *Value — the services provided equal the services needed to accomplish the goal, at reasonable compensation.* Without plan goals (i.e., Step 1), needed services are vague, and provider selection focuses on the lowest common denominator, which is cost. Therefore, the Yugo wins.

Step 3: Participant-Driven Investment Menu

What is your organization's investment philosophy regarding the retirement plan? Again, this is a question many organizations have not addressed. Should participants have many investment choices or a few? Research indicates that at a certain level, more investment options actually result in lower participation. Should actively managed funds, index funds, or a combination be offered? Significant time is spent discussing investment performance in retirement plan committee meetings without first documenting fundamental beliefs. In the book *Save More Tomorrow*, Schlomo Benartzi states that approximately 90 percent of participants are delegators and prefer a "do it for me" investment option. Should that be risk-based funds, target-date funds, or managed accounts in which management fees are added in addition to the expense ratio of the fund? Does the value of the managed account outweigh the associated cost? These issues should be addressed, but for most plan sponsors these issues require the assistance of an investment advisor. The concept omitted most often is risk. In the age of information, investment performance information is readily available to almost any party. However, without considering the corresponding risk metrics, a committee can make an uninformed decision.

Summary

The retirement plan industry has changed significantly during the last five to ten years. Ten years ago the Department of Labor had not provided guidance on target date fund selection. Essentially, we were still at target date fund 1.0, asset allocation models. Automatic enrollment was available, but concerns over liability for selecting participants' investments over-shadowed the benefit of helping participants get on a path toward retirement. Behavioral finance had not been applied to the retirement plan industry. Organizations were not aware that participants actually want direction. Lifetime income and the need to convey information to participants in a different perspective were not on the radar of Congress, the Department of Labor, or the retirement plan industry. The issues that will arise in the next ten years have likely not been thought of yet, so plan goals can, and probably will, change. By following a prudent process, basing decisions on the latest research and routinely monitoring past decisions, plan sponsors can have confidence in reaching their retirement plan goals, whatever they may be.

Paul Powell is Managing Director — Southeast Region, NFP Retirement