RETIREMENT PLAN PERSPECTIVES

Insights for Your Plan and Employees

Q4 2022

Eyes on the Prize

Despite Challenges, Americans Remain Focused on Saving for Retirement

Despite facing economic uncertainty, market volatility, geopolitical unrest, and the ongoing Covid-19 pandemic, plan participants continue to save for retirement. Vanguard's annual report, How America Saves 2022, cited a number of encouraging factors that are contributing to this trend.

Plan Sponsor Support

The report noted that the pandemic has brought more attention to the financial instability of Americans (70 percent of Americans surveyed said financial anxiety over finances was their top stressor). In addition, during one of the tightest labor markets in recent history, employees' expectations are increasing. The report found that employers are increasingly realizing that anxiety over finances jeopardizes their employees' path to a successful retirement and affects their day-to-day lives. Employers are therefore working with their advisors to implement plan design strategies to get their employees enrolled and saving at higher rates. In addition, more employers are broadening their focus beyond retirement to help employees manage other basic financial needs, such as budgeting, debt management, emergency savings, and student loan repayment.

Contribution Rates Stay Steady

Vanguard's survey found that participants' median total contribution rate—including participant and employer contributions—was 10.4 percent in 2021, compared with 10.5 percent in 2020. Vanguard credited plan sponsors adopting automatic deferral and automatic escalation for the rate staying constant through the pandemic, market volatility, and rising inflation. Roughly half of retirement plan participants, however, continued to save below the recommended rate of 12–15 percent of their salary. Vanguard found that slight deferral increases could help close this savings gap because roughly 20 percent of participants saving below these levels are just 1–3 percent away from the target savings rate.

Growth in Managed Account Advice Services

Plan sponsors are also increasingly offering tools and resources to support employees with their saving and investment planning. Here are a few examples:

- Roughly 41 percent of all Vanguard DC plans offered managed account advice in 2021, compared with 30 percent in 2017.
- The percentage of participants who were offered managed account advice was 74 percent in 2021, compared with 55 percent in 2017.
- The percentage of participants who were offered managed account advice and used the service was 10 percent in 2021, compared with 7 percent in 2017.

Eyes on the Prize *(continued)*

Other Notable Progress in 2021

- Only 2 percent of participants stopped contributing, and only 7 percent decreased their salary deferrals.
- Approximately 17 percent of participants made a participant-directed increase, 25 percent made an increase due to auto-escalation, and 49 percent made no change.
- The participation rate for plans that used auto-enrollment was 93 percent, compared with 66 percent for plans that did not use the feature.
- Roughly 58 percent of plan sponsors using auto-enrollment increased the default contribution rate to 4 percent or higher.

Everybody Wins

Flexible Plan Design Features Can Help Improve Outcomes for Lower-Income Workers

Depending on the nature of your business and the varied experience, education, and expertise required of your workforce, you may have a significant population of lower-income workers. In a highly competitive hiring environment, the following plan design ideas can help attract and retain workers. By adding just a little flexibility to better accommodate your lower-income workers, everybody wins.

Automatic Features

The best way to get lower-income workers to participate is to automatically put them in the plan, according to research from the Program on Retirement Policy at the Urban Institute. At the same time, plan sponsors must also consider the effect on lower-income workers if it is paired with automatic escalation. Setting automatic deferral and auto-escalation rates too high can be particularly harmful to lower-income workers, who make their deferrals from lower earnings.

One tactic employers can use to help lower-income workers save is deferring part of their pay raise automatically into the retirement plan, rather than straight into their paycheck. These workers may not feel like they're losing out on something because they still get a slight bump in their salary, while also getting a boost in their retirement savings.

Adjusting the Match to Encourage Higher Deferral Rates

Employers and their advisor often adjust the plan's match rate to encourage higher deferral rates. Participants often defer up to the maximum rate required to receive the full match, according to research from the Program on Retirement Policy. The higher the level when the match ends, the more people feel encouraged to contribute. Plan sponsors wanting to increase lower-income workers' retirement savings by tweaking the match must avoid setting the threshold so high that these workers are priced out.

Combining a Financial Wellness Program with an Emergency Savings Program

The Defined Contribution Institutional Investment Association (DCIIA) recommends offering a financial wellness program, combined with an emergency savings program. Offering both programs emphasizes the importance of having sufficient savings to cover emergencies and is the most powerful tool available for lower-income participants. Findings from the Life Insurance Marketing and Research Association show that almost 30 percent of lower-income workers have no emergency savings fund, which can lead them to not save or to withdraw money from their retirement accounts. Funding an emergency savings account can give lower-income employees a sense of control and more security about their day-to-day experience. That's a great foundation to build before beginning a long-term retirement savings program.

Everybody Wins *(continued)*

Action item: The DCIIA defines low income as $20,000–$47,500 in annual household income.

Web Resources for Plan Sponsors

- Internal Revenue Service, Employee Plans: www.irs.gov/ep
- U.S. Department of Labor, Employee Benefits Security Administration: www.dol.gov/ebsa
- 401(k) Help Center: www.401khelpcenter.com
- *PLANSPONSOR* magazine: www.plansponsor.com
- BenefitsLink: www.benefitslink.com
- Plan Sponsor Council of America: www.psca.org
- Employee Benefit Research Institute: www.ebri.org

Plan Sponsors Ask . . .

Q: We are considering a plan design change regarding loans. Does data support offering just one loan per participant versus offering multiple loan options?

A: According to T. Rowe Price's Reference Point 2022, plans that allow multiple loans tend to have lower savings rates—dropping from an average deferral of 7.9 percent to 6.8 percent. Allowing a greater number of loans is also correlated with higher average loan balances: $10,162 for one loan, $12,424 for two loans, and $13,698 for three or more loans. The study suggests that, given the potential negative impact that allowing multiple loans has on savings, plan sponsors could consider limiting them to one per participant. This solution could satisfy participant need while also limiting the possibility of loans being used for less essential reasons, preserving important retirement savings.

Q: We have a group of plan participants who have asked us for additional education that covers topics more relevant to employees within 10 years of retirement. Our advisor has set up presentations that cover social security, Medicare, and income planning. What else might we consider?

A: A new research brief from the Center for Retirement Research at Boston College provides data and perspectives that could serve as content for an educational seminar. The brief, How Well Do Retirees Assess the Risks They Face in Retirement?, found that retirees don't have an accurate understanding of their true retirement risks, and there's a large disconnect between how actual and perceived risks are ranked. The analysis found actual risks should be ranked, in order: longevity, health, and market. Perceived risks, however, were ranked as market, longevity, and health. Specifically, Americans ages 50 and older are about three times more worried about market risk than the research modeling suggests they should be, 50 percent less worried about their own longevity risk than they should be, and 30 percent less worried about health care costs in retirement than they should be. The research also explores family risk, which has received increasing attention. Family risk includes divorce, death of a spouse, and adult children becoming ill or unemployed.

Q: One of my plan committee colleagues mentioned a new compliance program that was being launched by the IRS. Can you provide details?

A: The recently launched pilot compliance program starts with a letter from the IRS. The letter gives you 90 days to perform both a document and an operational compliance review. If you fail to respond to the letter within 90 days, the IRS will contact you to schedule an exam. Assuming you choose to conduct the appropriate review and discover errors, the errors may, if eligible, be corrected using the correction principles in the Employee Plans Compliance Resolution System. If the errors aren't eligible for such correction, you may request a closing agreement and pay a sanction determined pursuant to the fee structure set forth in the Voluntary Correction Program. The IRS states that its goal with this program is to reduce taxpayer burden and the amount of time spent on retirement plan examinations. At the end of this pilot, the IRS will evaluate its effectiveness and determine if it should continue to be part of its overall compliance strategy.

Plan Sponsors Ask . . . *(continued)*

IRS 401(k) Contribution Limits for 2023

401(k) Maximum Elective Deferral	$22,500*
Defined Contribution Maximum Annual Addition	$66,000
Highly Compensated Employee Threshold	$150,000
Annual Compensation Limit	$330,000

**$30,000 for those age 50 or older, if plan permits*

IRS 401(k) Contribution Limits for 2022

401(k) Maximum Elective Deferral	$20,500*
Defined Contribution Maximum Annual Addition	$61,000
Highly Compensated Employee Threshold	$135,000
Annual Compensation Limit	$305,000

**$27,000 for those age 50 or older, if plan permits*

For more information on these limits, please see the IRS news release.

Quarterly Plan Sponsor Calendar

January

- Send payroll and employee census data to the plan's recordkeeper for year-end plan testing (calendar-year plans).
- Audit fourth-quarter payroll and plan deposit dates to:
  - Ensure compliance with the DOL's rules regarding timely deposit of participant contributions and loan repayments
  - Ensure any changes (increases or decreases) to participant contribution rates are reflected in payroll
- Verify that employees who became eligible for the plan between October 1 and December 31 received proper enrollment notification with instructions on how to enroll. Send reminders to those who haven't enrolled.

February

- Update the plan's ERISA fidelity bond coverage to reflect the plan's assets as of December 31 (calendar-year plans). Remember that if the plan holds employer stock, bond coverage is higher than for nonstock plans.
  - Report the new bond coverage amount to your recordkeeper so it will be reflected properly on Form 5500.
- Issue a reminder memo or email to all employees to encourage them to review and update, if necessary, their beneficiary designations for all of their benefit plans.
- Perform annual charter review for plan fiduciaries and their roles.
- Provide quarterly benefit/disclosure statement and statement of plan fees and expenses actually charged to individual plan accounts during prior quarter, within 15 days of end of last quarter

Quarterly Plan Sponsor Calendar *(continued)*

March

- Review all outstanding participant plan loans to determine whether there are delinquent payments. Also, confirm that each loan's repayment period and the amount borrowed comply with legal limits.
- Check and update employee benefit resources, including intranet, employee portals, or bulletin boards (virtual and traditional), to ensure that all plan materials are easily accessible, complete, and current.

Consult your plan's financial, legal, or tax advisor regarding these and other items that may apply to your plan.

We Can Help

Are you considering a match increase, profit sharing, or nonelective contribution rates? Changing to a safe harbor plan? Remember that any amendments must be made in advance of the effective date and often within the same plan year.

Tip: Contact your recordkeeper or third-party administrator to discuss these proposed ideas so they can help coordinate the operational and administrative requirements to implement them.

Authored by the Strategic Retirement Solutions team at Commonwealth Financial Network.

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