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MARKETBLOTTER: 401(K) TRENDS IN 2017

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Summary

Market and economic factors, regulatory changes, and demographics are collectively influencing trends in the 401(k) marketplace today.

From the inception of the 401(k) plan as a savings tool through the present, there has been a prolonged period of growth in major stock and bond indices, as well as the US economy as a whole. However, general forecasts for growth in the decade ahead have been tempered by major institutional investment managers like BlackRock1.

With the U.S. Department of Labor's Fiduciary Rule here to stay, employers are placing more emphasis on their fiduciary responsibilities as plan sponsors. In a recent Fidelity survey, employers ranked concern about fiduciary responsibilities the number one reason for hiring an advisor for the first time ever 2.

With both trends in view, plan sponsors are beginning to think differently about the types of investments offered in their 401(k) plans. However, less than 15% of employers have adequately informed their participants about the claw back in financial market and economic growth forecasts3.

Similarly, a majority of those heading into retirement do not feel thoroughly prepared for the transition from a financial perspective4. This signals a need for improvement in financial education and planning resources on the part of both participants and plan sponsors.

Tempered Growth: The Newest Normal?

When the IRS adopted section 401(k) of the Internal Revenue Code on November 6, 1978, the S&P 500 closed at 95.19. On June 1, 2017, the S&P 500 closed at 2,427.15. While most of the exponential growth in the index came in the mid to late 1990s and again over the past eight years, it is fair to say for most of the existence of the 401(k) plan, the growth of U.S. stocks has been exponential. With easing monetary policy on the part of the Federal Reserve Bank and most major central banks, the value of corporate bonds also increased steadily during much of this same period. However, U.S. economic growth as measured by the annual GDP Growth rate has gradually slowed, particularly over the past decade.

This economic environment has created a changing landscape of opportunity for 401(k) participants going forward. Some major institutional funds managers are calling for tempered U.S. economic and market growth expectations in the years ahead. Thus, the decade ahead may look very different in terms of how participants invest in their 401(k) plans as compared to the past few decades.

Course Corrections

401(k) plan participants have three primary options for making up the gap created by tempered growth forecast: work longer, save more, or a combination of both. In a recent BlackRock survey, a majority of respondents stated they would choose to save more in their employer's retirement plan over working longer3. The same was true of employers who were asked which option they would prefer for their retirement plan participants. This means

plan participants will most likely have to consider lifestyle and spending-habit changes and free up additional cash flow to increase plan contribution rates.

Employers are also reevaluating their roles as plan sponsors in light of tempered growth expectations. This includes a fresh look at some traditional investment options, such as index funds and target-date funds3. Target-date funds have come under increased scrutiny in recent years from both a management-style perspective5 and a cost perspective6. It appears plan sponsors are finally catching up with the times. Opportunities for improved investment performance and reduction of fund management fees are now the number one and number two reasons behind changes to investment menus by plan sponsors, according to Fidelity Investments2.

Knowledge Is Power…Still

Two landmark academic studies on financial education in the workplace were released nearly a decade ago7,8. These were followed by repeated calls for increased emphasis on workplace financial education by major publications and news media outlets, such as Forbes9. Since that time, financial literacy for plan participants has been an area of increased focus for employers. However, this has not necessarily translated into practical knowledge on the part of plan participants or resulted in adequate adjustments to contribution rates, according to recent plan survey data3. Going forward, employers may have to rethink how they communicate with plan participants and how they monitor progress toward retirement goals.

This matter is highlighted by the fact that 88% of plan sponsors queried in a major survey2 stated participants in their plans had actually delayed retirement due to a lack of savings. Additional education and tools will become necessary to bridge the gap, as the "rule-of-thumb" six percent contribution rate – which inadvertently became an accepted baseline – does not appear adequate to meet the needs of most plan participants today. Contribution rates well in excess of ten percent may be necessary for participants who want to achieve their retirement goals going forward, according to research provided by BlackRock1.

What Is Working

There are some points of positive news in recent retirement planning trends. Employer satisfaction with plan advisors and consultants is at an all-time high, according to Fidelity2. And a majority of employers surveyed agreed they were getting value from the relationship with their advisor.

Ironically, this same survey indicated plan sponsors searching for a new advisor was also at an all-time high. This could mean employers are paying more attention to their 401(k) plans, as a whole, and to what parties are involved in advising and administering their plans. This is potentially good news for plan participants, who can benefit from lower fees and costs, as well as from a more hands-on approach to plan design.

What Should You Do?

As a 401(k) plan participant, it is important to understand a few key items:

1) What fees and expenses does my plan pay and to whom are they paid? You can find more information by requesting a copy of your plan's 408(b)(2) fee disclosure. This is easily obtained by contacting your plan's recordkeeper (sometimes referred to as the "service provider") or advisor. You should also be supplied with a copy of this disclosure on an annual basis. If you need help interpreting the details, contact the plan recordkeeper, your employer's benefits manager, or your licensed financial advisor for assistance.

2) How do I know how much I should contribute from my paycheck? There is no standard contribution amount. Your plan's recordkeeper or advisor should provide you with tools for calculating how much you should contribute based on three factors: when you want to retire, what you expect your spending habits/needs to be in retirement, and how much investment risk is acceptable to you. The suggested contribution rate may seem overwhelming at first, but do not let that deter you from making the necessary adjustments to reach your long-term goals.

3) How do I know which investment funds to pick and how I should be invested? Your retirement plan's recordkeeper or advisor should provide you with tools to make these decisions, either online or via in-person consultation. For a second opinion, you may wish to contact your licensed financial advisor or Certified Financial Planner (CFP®).

As an employer who sponsors a retirement plan, you should consider the following:

1) Have I properly defined, understood, and accepted (or mitigated) my fiduciary responsibility? You must know the difference between an ERISA 3(21) and an ERISA 3(38) fiduciary role, and what party has accepted each role in the oversight of your 401(k) plan. Presumption of responsibility does not equate to assumption of responsibility. Your plan's recordkeeper or advisor should be able to delineate between these types of fiduciary duties and help you determine the best course of action for the size and nature of your business and your retirement plan.

2) Is my plan advisor or consultant looking out for my best interests and the best interests of my participants? Ultimately, as a plan sponsor and employer, you are accountable for what your advisor/consultant is doing to ensure your 401(k) plan is up to par. Under the new Department of Labor Fiduciary Rule which went into effect June 9, 2017, plan participants have the right to engage in class action lawsuits against all parties to a 401(k) retirement plan. Ensuring that all parties – and particularly your advisor – are acting in the best interest of your participants is a necessity now more than ever. The good

news is, advisors and consultants will be competing for this business more actively and the best providers should rise to the top over time.

3) Are my employees receiving the education they need in a way that actually helps them? With so many tools available to educate plan participants these days, sifting through the menu of options can be challenging. Those which emphasize income-distribution planning and individual risk benchmarking seem to be gaining popularity. However, the key remains getting your employees to engage with the offerings you make available. Programs which proactively emphasize overall financial literacy remain the most effective way to increase contributions, reduce borrowing against plan assets, and provide less stressful transitions for retirees.

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