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Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

The Three Funds We Recommend

Behavioral Economics teaches many lessons. First, sometimes less is more. Nowhere is this truer than in retirement plans, where offering fewer funds drives greater participation and less confusion. When building an optimal retirement plan, we continuously conclude the ideal number of investments to be three - three index-based fund options, that is. One index investment has been the norm for years, with most plans typically offering an S&P 500 fund, which covers only large cap U.S. stocks. Some plans contain an entire menu of index-based options, which in our view, is superfluous. If there are more than three broadly based index funds, the advantages of indexing diminish because they begin to resemble their actively managed counterparts. From an investment strategy perspective, the best index options capture broad market exposure at a low cost. When broad-based index funds are deconstructed to represent certain styles, sectors and investment niches, diversification suffers and costs generally increase, creating the quintessential situation to avoid. In these instances, active managers usually do a better job.

Thus, to the next question: What is the optimal “three-pack” of index funds?

1) a broad U.S. (total) equity index fund,
2) a broad international (total) equity index fund,
3) a broad U.S. (total) bond index fund.

These are the three index funds (consider them building blocks) that allow participants to construct an efficient market portfolio at any point along their retirement glide path. With simply these three options, a participant can diversify themselves with over 8,000 stocks and 15,000 bonds. This broad type of diversification is the purpose of the funds, and what they do best. In fact, there

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The Importance of Qualitative Review

The qualitative review of a mutual fund helps support the quantitative analysis within the Scorecard System™ by providing color and insight into the portfolio and the investment performance. The qualitative review process is structured in its approach and designed to identify the factors that will ultimately drive future investment performance. The three primary factors include: **People**, **Process** and **Philosophy**. The baseline criteria are set for each:

People
Is there an experienced team with the ability to manage both philosophy and process? You must weigh factors such as

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Considering a Safe Harbor Retirement Plan

It may be advantageous for a plan sponsor to consider adopting a safe-harbor design for their retirement plan. Adopting a safe harbor retirement plan design permits an employer to essentially avoid discrimination testing (the testing is deemed met). Remember, this testing limits highly compensated employees' contributions based upon non-highly compensated employees' contributions. By making a safe harbor contribution, highly compensated employees can defer the maximum amount allowed by their plan and Internal Revenue Code limits, without receiving any refunds. General rules for all safe harbor contributions include the following:

- Safe harbor contributions are 100% vested.
- There may be no allocation requirements imposed on safe harbor contributions, for example, a 1,000-hour service requirement or a last day employment rule.
- Safe harbor contributions may be used toward satisfying the top-heavy plan minimum contribution requirement.
- All eligible participants must receive a written notice describing the applicable safe harbor provisions between 30 and 90 days before the beginning of the plan year. This notice must be provided for each year the plan will be safe harbored.

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Summary Plan Description Reminder

A summary plan description (SPD) describes the key provisions of an employer's retirement plan and participant rights. SPDs must be disseminated to newly eligible participants within 120 days after a new plan is established or within 90 days after a participant becomes eligible to participate in an existing plan. In addition, SPDs must be disseminated to all participants once every five years unless there have been no amendments to the plan during that period. The DOL issued final regulations on electronic delivery that indicate an SPD can be delivered through an electronic medium if all the requirements are satisfied. Contact your plan consultant for assistance with your SPD or other plan-related documents.

Three Funds

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are few actively managed funds that give investors exposure to this large number of stocks and bonds. The average actively managed stock or bond fund holding totals only in the hundreds, if that. Keep in mind that this is by design as active fund managers attempt to select the best stocks and bonds. At the same time, this limits the number of holdings in their portfolios, and diversification suffers as a result. Index funds accomplish all of this at an extremely low cost. The strategy is simple; an index-based option buys and tracks the companies in the index. An S&P 500 fashioned index fund, for example, buys those 500 companies represented in the index. They are held until there is a change in the index. This is what typically causes an index fund to resemble a "buy and hold" strategy.

With an optimal "three-pack" of index funds in a plan, the opportunities for participants are endless. They can represent the entire portfolio or a core of it, with other active funds and then add a cash-equivalent into the mix as well. This "three-pack", however, is only achievable with appropriate broadly based index funds specifically, U.S. equity, international and fixed income. At sometimes less than half the cost and with over twice the diversification, this structure is optimal for retirement plans and why we recommend only three. When considering index funds, less is actually more.

Qualitative Review

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changes within the firm's leadership and organization as well as the experience and ability of a portfolio manager.

Process
Is the process clearly defined and consistently applied? Is the process sound and established? The implementation of a strategy may be just as, if not more important than, the ideas and research supporting it.

Philosophy
The research and ideas must be coherent and persuasive with a strong rationale supporting past results and future performance expectations.

Safe Harbor

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Generally, there are two types of safe harbor contributions: 1) the non-elective contribution, which is a 3% contribution to all eligible participants, or 2) a matching contribution to participants who are contributing to the plan. There are two options from which to choose, for the matching contribution, either the basic or the enhanced match. The basic safe harbor matching contribution is defined as a 100% match on the first 3% of compensation deferred and a 50% match on deferrals between 3% and 5% of compensation. Alternatively, the employer may choose an enhanced matching formula equal to at least the amount of the basic match; for example, 100% of the first 4% deferred. All that said, employers wishing to explore a safe harbor solution should also be aware that it may entail more cost (if their present contribution structure is less than the required safe harbor required structure).

To learn if a safe-harbor feature is appropriate for your plan, contact your plan consultant.

COMMUNICATION CORNER: Retirement Puzzle

This month's employee memo encourages participants to have a little fun while learning about retirement plans. The featured puzzle has eight hidden retirement terms for participants to find.

Call or email your Plan Consultant if you have questions or need assistance.

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