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Employee Benefits Update

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Staging a comeback

Stable value funds are back in the spotlight

It's been awhile since stable value funds reigned as a top investment choice for 401(k) plan participants. Very low prevailing interest rates and a booming stock market have diminished their status. Although no one is predicting they'll unseat target date funds as the top investment election for retirement investors, stable value funds have staged a bit of a comeback recently.

Types of funds

According to the Department of Labor, a stable value fund is an "investment product or fund designed to guarantee principal and a rate of return generally consistent with that earned on intermediate investment grade bonds, while providing liquidity for withdrawals by participants and beneficiaries, including transfers to other investment alternatives."

Stable value funds consist of portfolios of short- and intermediate-term bonds, but with an insurance contract overlay, or "wrapper," and come in two types:

1. Direct contract. These are issued by a single insurance company that guarantees the fund's principal and yield over a specified time period. The guarantee of the minimum promised yield and return of principal is backed by the insurance company's general assets.

When selecting a stable value fund provider, the same due diligence is required as when selecting any other plan investment.

2. Collective investment trust. These trusts consist of multiple underlying insurance contracts. The compensation for a collective investment trust's lower yield is a higher level of security derived from that diversification. However, direct contract stable value funds generally have higher (perhaps by 30 basis points) yields than collective investment trusts.

The strong insurance backing of stable value funds doesn't get plan sponsors off the fiduciary hook when selecting a stable value fund provider, of course. The same due diligence is required as when selecting any other plan investment. Some insurance companies are stronger than others, and some state guaranty associations are also more solid than others.

An uptick in assets

Specifically, stable value funds have risen from 10.4% of plan assets in 2014 to 12% in 2017, according to the Stable Value Investment Association (SVIA). That proportion hit 19% during the 2008 financial crisis, when average fund yields hovered around 5%.

Stable value funds as temporary QDIAs

Stable value funds can serve as a *temporary* qualified default investment alternative (QDIA). Under Department of Labor regulations, four types of investment options qualify as QDIAs:

1. **A product with a mix of investments that takes into account the individual's age or retirement date (such as an age-based life cycle or target date fund),**
2. **A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (such as a balanced fund or risk-based lifestyle fund),**
3. **An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (such as a professionally managed account), and**
4. **A capital preservation product (such as a stable value fund) for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration if workers opt out of participation before incurring an additional tax).**

If plan sponsors choose to use a stable value fund as a temporary QDIA, they must transfer the participants' accounts to one of the first three QDIA options listed above by the end of the 120-day period.

The SVIA sees two reasons for this uptick. First, in 2016, the SEC issued regulations requiring money market funds sold to "retail" investors to invest exclusively in government securities. These funds yielded very low interest rates. About 13% of plan sponsors who made changes to their fund offerings in response to that regulatory change added a stable value fund to their plans, according to Callan Associates research.

And, some plan sponsors regard stable value funds as a higher yield alternative to money market funds. Current average stable value fund yields are hovering in the 2.5% range, according to the SVIA, vs. around 100 basis points for money market funds.

Second, stable value funds could provide for a smoother ride than higher-yielding bond funds for retirement savers in a rising interest rate environment — a long-predicted economic scenario that has yet to occur in any significant way. The smoother ride would stem from the fact that yields on stable value funds are by definition stable — with guaranteed minimum yields and "crediting rates" (interest actually paid) generally level for six-month periods — even if the market values of their underlying short- and intermediate-term bonds aren't.

In a rising interest rate environment, declining bond fund values could raise anxiety levels among retirement savers, and result in actual losses for retirees if forced by financial necessity to liquidate some of their depressed bond fund holdings in retirement.

Time to decide

Your ultimate analysis will involve the suitability of a stable value fund for your employee population. While a stable value fund might provide a reasonable alternative to bond funds for particularly risk-averse plan participants, few would be well served by seeking the shelter of a stable value fund as an alternative to a well-diversified portfolio. Contact your benefits specialist to learn whether these funds are right for your plan. □

Are you going to file Form 5500 on time?

Play it safe and avoid penalties

Missing filing deadlines for Form 5500, "Annual Return/Report of Employee Benefit Plan," for retirement and health and welfare plans can be extremely costly. The best way to avoid any trouble is to have safeguards in place to ensure that meeting filing deadlines never falls between the cracks.

Adding up penalties

How costly is a missed Form 5500 deadline? The maximum penalty for 2017 is now $2,097 per day after the filing deadline, for filing violations that have occurred on or after November 2, 2015. The Department of Labor (DOL) adjusts the civil penalties each year. The previous $1,100 daily penalty ceiling is still applied to delinquency periods that started before then.

That means, for example, that if you inadvertently neglected to file a 5500 that was due on September 1, 2015, and didn't file it until December 1, 2017, you could owe up to approximately $66,000 for the period before the penalty rose, and then approximately another $1.6 million for the remaining period of the delinquency.

Remember that the penalties noted are assessed by the DOL. The IRS can impose additional penalties for late filings. Currently the penalty is $25 per day up to a maximum penalty of $15,000.

Cumulating penalties

If you neglect to file two years' worth of Forms 5500, the penalty calculation is cumulative. That is, the DOL calculates the fine based on the sum of the total days late each form was, as opposed to just counting the days since the first late form was due.

If you fail to furnish all the data required on the Form 5500 — such as not attaching an independent auditors' report if your plan requires it — you could still be in trouble. The DOL can treat the filing of an incomplete Form 5500 in the same way as not having filed the form at all. Generally, though, the DOL will give you a heads-up, and you'll have 45 days to submit the missing information before becoming subject to penalties.

Remedying potential delinquency

If you discover that you're delinquent with a Form 5500 filing, you might have an opportunity to reduce your penalties under the DOL's Delinquent Filer Voluntary Compliance Program (DFVCP). You must do so before receiving a notice of your filing delinquency from the DOL. It's a two-step process:

Step 1. Electronically file a complete Form 5500 or Form 5500-SF, with all necessary schedules and attachments, using the DOL's EFAST e-filing system (efast.dol.gov).

Step 2. Use the online calculator to calculate your penalty, and then pay it either electronically or by check.

The penalty for small plans (those with fewer than 100 participants) is $10 per day for each day the annual report is filed late, to a maximum of $750 (or $1,500 if multiple late filings are involved). Large plans must pay the same $10 per delinquent day penalty, but with a higher cap ($2,000 per plan or $4,000 for multiple late filings). If you use the DOL's DFVCP program through the DOL, it's likely that the IRS will waive any penalties that it may assess.

Keeping up to date

As a reminder, the normal deadline for the Form 5500 filing is seven months following the end of the plan year. But you can file for a two-and-a-half-month filing extension before the end of the basic seven-month filing deadline, using Form 5558, "Application for Extension of Time To File Certain Employee Plan Returns." ☐

GAO report: Some plan designs may reduce retirement savings

Retirement plan sponsors have ways to limit their outlays for very young employees, and those that move to other employers soon after coming on board. The Government Accountability Office (GAO) recently analyzed those plan design opportunities, and is sounding alarm bells. It has expressed concerns to Congress that these options can reduce employees' ultimate retirement savings potential.

The report

The GAO focused on plan sponsors' ability to:

- Defer plan participation eligibility until age 21,
- Limit eligibility for a year's worth of matching contributions only to participants employed by the sponsor on the last day of that year, and
- Use vesting to limit participant claims on employer matching contributions until participants have logged a certain amount of years of participation in the plan.

The survey determined that 41% of plans feature a minimum age requirement of 21. The impact on an 18-year-old "average earner" based on what the participant would have deferred before age 21, including a 3% match, would be $134,456 less in savings by the time of retirement.

An average employee working for a company with an end-of-year employment requirement would come up short by $29,297 at retirement, according to the GAO report. Finally, the GAO considered the retirement savings impact for a worker who leaves jobs at two companies before meeting a three-year cliff vesting requirement, if those job changes occur when the employee is 20, then age 40. The GAO predicted lost retirement savings of $81,743.

The advice

The GAO report serves as a reminder for plan sponsors of the flexibility they do have — and might wish to exercise. If, for example, your plan allows employees as young as 18 to join the plan, but you experience high turnover among such young employees, you might opt to shift the participation eligibility age to 21. On the other hand, if you currently don't allow employees to join the plan until reaching age 21, and you're having a tough time recruiting workers below that age, you might consider moving in the opposite direction.

The road ahead

In the end, the GAO urges Congress to consider ERISA changes to prevent the lost retirement savings as outlined above. However, the prospects of Congress doing so aren't very strong. In the meantime, plan sponsors have the ability to design plans that will attract and retain employees. ◻

Compliance Alert

Upcoming compliance deadlines:

10/2* Deadline for establishing a new safe harbor 401(k) plan

10/2* Deadline for setting up a SIMPLE for 2017

10/16* Extended deadline for filing 2016 Form 5500

10/16* Deadline for funding employer profit sharing contributions and employer matching contributions

10/16* Extended deadline for filing 2016 Form 8955-SSA

10/16* Extended deadline for filing 2016 individual tax returns

10/16* PBGC Comprehensive Premium filing and payment deadline

11/1 2017 SIMPLE notice due to current participants

** This date reflects an extension of the normal deadline, which falls over the weekend this year.*

Target date fund labels can obscure their investment strategy

The proliferation of target date fund (TDF) varieties can bewilder many plan sponsors. One survey found that, while nearly two-thirds (65%) of plan sponsors consider investment performance the most important selection criterion when choosing a TDF for their participants, more than half (54%) aren't confident that they have a solid basis for benchmarking the TDFs against others in the marketplace. One of the biggest challenges is segmenting competing TDFs into logical categories for comparative performance analysis purposes.

What's the difference?

When TDFs were first introduced, they were typically divided into two basic groups, according to their glide path: "to" or "through" retirement. Under the "to" framework, the TDF's goal is to minimize participants' investment risk in stages until they reach retirement age (also called the "landing point"). At that time, the funds would be minimally exposed to market volatility, allowing participants to decide for themselves what their asset allocation should be and reset it according to their own wishes going forward.

The "through" model is built on the assumption that participants will remain invested in the fund through retirement. This means they need to maintain a significant (although diminishing) equity exposure at retirement to maintain sufficient capital to live on over the remaining years of their lives — at least two or three decades.

Apples-to-oranges?

The "to" vs. "through" categorization model for making apples-to-apples comparisons may have serious flaws, however. Importantly, it can cause sponsors to speed past the basic question of which glide path is

more appropriate in the first place — an assessment that needs to be revisited from time to time.

A pair of surveys from Cammack Retirement Group underscores the importance of reassessing the glide path regularly. In 2013, the first poll revealed that most participants were liquidating their 401(k) accounts at retirement, while most of their employers were using "through" TDF models. This mismatch could have jeopardized many employees' retirement income security. Three years later, however, a higher proportion of participants opted to remain invested and stay in their TDFs.

But even when taking into account participant investment behavior patterns at retirement, the to-vs.-through comparison model can still fall short. Basically, some would expect a "to" model glide path, no matter what the underlying portfolios, to be inherently more conservative than a "through" model. But it doesn't always work out that way. Why? Because there aren't hard and fast definitions or standards regarding the labeling of TDFs.

A review of TDFs billing themselves as employing the "to" model can reveal widely divergent equity exposures at the landing point, ranging from below 10% to nearly 60%. Similarly, when glide paths of a variety of TDFs — some self-described as "to" and others as "through" — are categorized on a conservative-to-aggressive spectrum, you'll find both self-described "to" and "through" TDFs falling in the "conservative" grouping.

How to compare TDFs?

Remember that the glide path and composition of a TDF's underlying portfolios won't remain fixed indefinitely. Competing TDF providers are mindful of how they perform relative to each other. They recognize that many participants and plan sponsors will simply compare investment returns of various TDFs with the same target date. Without more research, prospective participants and sponsors won't understand why competing TDFs might have divergent investment performances over a particular time period because of their different glide paths.

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For example, during a long period of strong domestic equity performance, it might be tempting for "TDF X 2030" to move its equity allocation up a notch or two to appear more competitive compared to "TDF Z 2030," which had always maintained a higher equity allocation than "TDF X 2030." You might have chosen TDF X specifically because its glide path was conservative. An abrupt change in equity market trends could result in poorer performance for "TDF X 2030" than would have been the case if competitive pressure hadn't prompted it to tinker with its glide path.

The bottom line

In the final analysis, "to" and "through" labels say more about how TDF providers view themselves, not necessarily how plan sponsors and participants might view them. Take the time to research any TDFs you want to include as part of your retirement plan. The DOL's *Target Date Retirement Funds — Tips for ERISA Plan Fiduciaries* has helpful information so that you can offer what's best for the plan and your participants. (On the DOL website, click on the magnifying glass symbol and type "Tips for ERISA" in the search box to reach the link.) ◻

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