A Plan Sponsor’s Fiduciary Calling to Improve the Retirement Readiness of Plan Participants

Important Information

The Wagner Law Group has prepared this guide on behalf of LPL Financial. It is intended for sponsors of 401(k) plans and other types of defined contribution retirement plans with participant-directed investments that are subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA). This guide is intended for general informational purposes only, and it does not constitute legal, tax or investment advice on the part of The Wagner Law Group, LPL Financial or their respective affiliates.
Plan sponsors and other fiduciaries have good reason to help plan participants with their retirement readiness. The U.S. Department of Labor’s “404a-5 Regulations” impose an implied duty on plan sponsors to promote the financial literacy of the plan’s average participant, and to educate participants on how they may save and invest through their plan. If plan sponsors offer participant guidance in the form of “safe harbor” non-fiduciary education, the plan sponsor will be protected against any potential fiduciary liability that might arise from such participant guidance. Plan sponsors who improve the retirement readiness of their plan participants can avoid unnecessary risk, potential liability and can enjoy significant economic benefits from enhanced workplace productivity. To help satisfy their fiduciary duties under ERISA and minimize any unnecessary risk, plan sponsors should strongly consider implementing the following best practices to promote retirement readiness:

1. **Evaluate Retirement Readiness at Plan-Level.** Plan sponsors can evaluate the retirement readiness of plan participants in the aggregate by looking at various factors, such as the overall rate of plan participation, the plan’s median contribution rate and median account balance and by identifying the plan’s popular investment alternatives.

2. **Implement Retirement Readiness Communication and Education Program.** Plan sponsors should consider developing a communication strategy that highlights the urgency of preparing for retirement and conveys a clear “call to action.” The plan sponsor should consider engaging a qualified provider to implement a “retirement readiness” education program to supplement its communication strategy.

3. **Integrate Readiness Assessment into Education Program.** The plan sponsor’s education program should incorporate a realistic assessment of a participant’s level of retirement readiness, which can help motivate participants to take immediate action. The plan sponsor should ensure such guidance qualifies as “safe harbor” non-fiduciary education to enjoy the benefits of fiduciary liability protection.

4. **Adopting Plan Design Changes to Promote Retirement Readiness.** Certain elements of a plan’s design can heavily influence a plan’s participation rate, how much participants contribute and how they invest their accounts. To help promote retirement readiness, plan sponsors should consider adopting: (a) Automatic Enrollment and Escalation, (b) a Default Investment Alternative and (c) a Lower Percentage Match.

It is important for plan sponsors to realize that their plans may be harboring significant and unnecessary risk from a fiduciary liability perspective if participants do not understand their plan and if their retirement savings are inadequate. By implementing the best practices described above, plan sponsors can readily help their participants get “retirement ready” and help them navigate toward financial independence. If a plan sponsor needs assistance implementing any of these best practices they should consider engaging a financial advisor or another qualified provider of participant education services.
Introduction – Helping Participants Get Ready for Retirement

Saving for retirement is universally understood to be a smart thing to do, and yet a large number of people fail to set aside and invest enough money for their future retirement needs. Many younger employees have yet to start saving for their retirement, and certain older workers who are fast approaching retirement lack the necessary funds to enter their golden years with any real measure of financial security. Other than a family home, a worker’s 401(k) plan account will often times represent the crux of his or her personal wealth. However, according to a recent government study, the median account balance for participants in defined contribution retirement plans is only $22,800, and the median account balance among workers age 60 to 64 is only $60,600.¹

Many plan sponsors are now concerned that a significant number of their employees will not be financially ready when their respective day of retirement inevitably arrives. An aging workplace with a growing number of older workers who work solely because they cannot afford to retire can hurt both morale as well as workforce productivity. Insufficient retirement plan savings can also lead to participant complaints being launched against the plan, which in turn may cause the fiduciary decisions made by the plan sponsor to be called into question.

This white paper will discuss the importance of helping plan participants pursue retirement readiness, and the relevant rules under the Employee Retirement Income Security Act of 1974, as amended (ERISA), the federal law that governs employer-sponsored 401(k) plans, 403(b) plans and other similar defined contribution plans. It will also include suggested best practices that should be considered by plan sponsors and other fiduciaries to assist plan participants prepare for their retirement years.

An Implied Duty to Educate the “Average” Plan Participant on Retirement Investments

Plan sponsors and other fiduciaries have good reason to help plan participants with their retirement readiness. ERISA imposes certain basic duties on plan sponsors and other fiduciaries to plans with participant-directed investments, which are designed to ensure that the plan participants have sufficient information to make informed investment decisions for their individual plan accounts. The U.S. Department of Labor (DOL) recently issued a set of regulations (404a-5 regulations), imposing a new fiduciary duty on plan sponsors that requires them to deliver detailed information to participants concerning the plan’s investment options on an annual basis as well as fee and expense information on a quarterly basis.² These participant-level disclosure rules focus largely on investment performance and expenses.

Even though the 404a-5 regulations do not require plan sponsors to educate participants on how they should save and invest for their future retirement needs, these rules do in fact require the mandatory disclosures to be written in a manner to be understood by the “average” plan participant. Thus, in spite of the fact that there is no direct requirement to ensure participants are financially literate, it may be helpful for plan sponsors to view the 404a-5 regulations as including an “implied” duty to educate the average plan participant and to help plan participants understand the mandatory disclosures as well as how they can save and invest through the plan.


² Section 2550.404a-5(c) of the DOL regulations.
Safe Harbor for Participant Guidance
As stated above, the DOL's 404a-5 regulations impose an implied duty on plan sponsors to promote the financial literacy of plan participants and to help them understand how they can save and invest through the plan. So that plan sponsors will not be penalized when providing this type of assistance to their participants, the DOL has established a “safe harbor” that protects plan sponsors when they offer participant investment education.

In the past, plan sponsors were often concerned that such assistance might be viewed as fiduciary investment advice, subjecting them to fiduciary liability to the extent such advice was provided imprudently and in a manner that led to participants suffering economic harm. However, in light of the importance of equipping participants “with information designed to assist them in making investment and retirement-related decisions appropriate to their particular situations,” the DOL issued protective guidance to plan sponsors in the form of Interpretive Bulletin 96-1.\(^3\) This guidance describes various categories of participant assistance that will qualify as non-fiduciary investment education, for which the plan sponsor would not be subject to any fiduciary liability.

Interpretive Bulletin 96-1 describes four safe harbor categories of non-fiduciary investment education as follows:

1. **Plan Information**, such as guidance discussing the advantages of plan participation, the benefits of increasing plan contributions and other plan-related information.
2. **General Financial and Investment Information**, which includes guidance helping participants estimate their future retirement income needs, determine their investment horizons and understand other related financial concepts.
3. **Asset Allocation Models** in the form of model portfolios for hypothetical investors with different time horizons and risk profiles.
4. **Interactive Investment Materials**, such as worksheets and software tools that help participants estimate their future retirement income needs and assess the impact of different asset allocations on retirement income.\(^4\)

Given the wide breadth of these categories, plan sponsors should be able to offer retirement readiness educational guidance to participants, which also qualifies as non-fiduciary education under the DOL’s safe harbor rules. This shields the plan sponsor from any potential fiduciary liability that might otherwise arise from such guidance.

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\(^3\) Section 2509.96-1 of the DOL regulations.

\(^4\) If the Asset Allocation Models or Interactive Investment Materials reference specific investment alternatives available from the plan’s menu, the relevant materials must state that other similar investment alternatives may be available and include other disclaimers to qualify as “safe harbor” education under Interpretive Bulletin 96-1.
Avoiding Unnecessary Fiduciary Risk and Potential Liability

Plan sponsors who improve the retirement readiness of their plan participants can also avoid unnecessary fiduciary risk and potential liability and can enjoy significant economic benefits from enhanced workplace productivity.

A happy employee is less likely to be a litigious employee. Generally speaking, if employees are satisfied and confident that their retirement plan savings will help them meet their retirement needs in the future, they should have little motivation to file legal claims against the plan’s fiduciaries or join a class action lawsuit. And even if a plan participant were to file a legal claim in court or with the DOL, the plan sponsor’s potential fiduciary liability generally would be limited to the size of the participant’s economic loss. The better participants are at saving and managing their plan accounts, the smaller any potential economic loss would be, which, in turn, would reduce the plan sponsor’s potential fiduciary liability in any plan-related litigation. It should also be noted that educated participants who are sophisticated enough to appreciate the risk-return tradeoff found across all investments would typically be less inclined to complain about any short-term volatility in the share price of a fund with risky investment features.

In addition to effectively serving as a risk management tool, comprehensive participant education focusing on the retirement readiness of an employer’s workforce can also boost morale and help foster an employee’s good will toward his or her employer. Conversely, if older workers continue employment with their firm solely because they cannot afford to retire, they may feel that their employer, which is ultimately responsible for operating the retirement plan, has failed them in some way. Another potential concern is that, as the number of workers who cannot afford to retire rise at a firm, feelings of resentment may become widespread and may cause a significant drag on workplace productivity.

Best Practices for Plan Sponsors

The good news is that plan sponsors can make a real difference in how their employees prepare for retirement and they can help improve their retirement readiness by implementing the suggested best practices described below.

1. Evaluate Retirement Readiness at Plan-Level

Although certain employees will have a significant amount of wealth outside of the firm’s retirement plan, in many instances, an employee’s personal assets will largely be limited to a family home and the investments in his or her plan account. Assuming that the average participant’s personal wealth is principally tied to the size of his or her plan account balance, plan sponsors can readily evaluate the retirement readiness of plan participants in the aggregate. For example, they can make this evaluation by reviewing the overall rate of participation in the plan, the median contribution rate of the plan’s participants and the size of the median account balance and by identifying the investment alternatives that are popular among the participants.

By performing this evaluation, plan sponsors can determine the overall health of their plan and whether it is accomplishing its goals. This initial evaluation will also help plan sponsors gauge the level of urgency and their need to take action to help participants prepare for retirement. If a plan sponsor needs assistance conducting this evaluation, it should consider consulting a qualified financial advisor or consultant.
2. Implement Retirement Readiness Communication and Education Program

An often cited hurdle that stops employees from even starting to save for retirement is behavioral inertia and their own tendency to procrastinate. For this reason, it is critical for plan sponsors to develop a communication strategy which highlights the urgency of preparing for retirement. Due to the power of compounding, a fundamental investment concept, participants who start contributing to a tax-qualified plan at an early age have a tremendous advantage over those who start at a later point in their respective careers. The first step to improving the retirement readiness of plan participants is to make a convincing case that they need to develop a game plan and take action immediately. This call to action should be a central part of the plan sponsor’s communication strategy.

In conjunction with an appropriate communication campaign, the plan sponsor should consider implementing a retirement readiness education program. One simple but effective approach would be to engage a qualified provider of participant educational services to help participants assess their retirement readiness and to offer related education sessions on an ongoing basis to reinforce the importance of staying on track with their retirement goals.

3. Integrate Readiness Assessment into Education Program

As discussed, when implementing a retirement readiness education program, plan sponsors can motivate participants to prepare for their own retirement by stressing the importance of getting started. One compelling way to engage participants and to get them to take immediate action is by providing a realistic assessment of each individual participant’s level of retirement readiness.

Many financial advisors and providers of plan administrative services offer internet calculators and web tools that are designed to help participants evaluate whether they are on track for a successful and financially secure retirement. These tools typically help participants calculate their estimated financial needs and wants during their retirement years. They also help them estimate the total amount necessary at retirement as well as the annual savings rate necessary to achieve a desired level of retirement income. Tools that include a gap analysis demonstrating how a participant’s current rate of savings may result in a shortfall at retirement can be especially effective in sounding a call to action for participants, encouraging them to act immediately to improve their retirement readiness.

In addition to offering internet web tools, providers of participant educational services may also offer one-on-one counseling by telephone or through periodic onsite visits. Regardless of whether these services are provided in the form of personal counseling or through web-based tools, the plan sponsor should ensure that the guidance provided to participants qualifies as “safe harbor” investment education for purposes of Interpretive Bulletin 96-1. So long as the guidance falls under one or more of the DOL’s safe harbor categories, the plan sponsor will not be subject to any fiduciary liability in connection with these participant services.
4. Adopting Plan Design Changes to Promote Retirement Readiness

Certain elements of a plan’s design can heavily influence a plan’s rate of participation, how much participants contribute to the plan and how they invest their individual accounts. Accordingly, plan sponsors should consider adopting any plan design changes that are strategically designed to help promote the retirement readiness of participants.

**Automatic Enrollment and Automatic Escalation.** Many plans have implemented automatic enrollment and default contribution features that have successfully boosted their participation rates. Some plans automatically enroll newly eligible employees only, while others have automatically re-enrolled their existing participants. In light of the risk that automatically enrolled participants may blindly and mistakenly assume that the plan’s default contribution rate is adequate for their future retirement needs, plan sponsors should be sure to select a default contribution rate that will help them save for retirement in a meaningful way. And if a plan sponsor does not want to set an initial default contribution rate that is too high, they can also provide for the automatic escalation of the default rate on an annual basis until a meaningful contribution rate is reached. Of course, plan sponsors should not be overly concerned that the plan’s default contribution rate is too high, since participants can always opt out and select a lower contribution rate.

**Default Investment Alternative.** Plan sponsors should also consider designating one of the plan’s balanced or target-date investment options as a default investment. A default investment is customarily required for plans with automatic enrollment features, but it is also necessary for plans that utilize “simple enrollment” forms for newly eligible employees. Designating a default investment is particularly helpful to participants seeking a quick and hassle-free way to complete the plan enrollment process. It can also help improve investment results for those participants who are not experienced investors.

**Lower Percentage Match.** A substantial number of participants will only contribute the minimum amount necessary to take full advantage of the plan’s matching contributions. Given this reality, plan sponsors may wish to consider lowering their percentage match under the plan (while maintaining the same maximum match amount) to encourage higher participant contribution rates. For example, if a plan were to offer a 50% match on participant contributions subject to a maximum match equal to 3% of pay, a participant seeking the maximum match would need to contribute 6% of pay. On the other hand, if the plan were to offer a 33 1/3% match, the participant would need to contribute 9% of pay to obtain the maximum match.

Before a plan sponsor changes its percentage match, they should consult with legal counsel to ensure such change does not adversely impact the plan’s nondiscrimination testing as mandated by the Internal.

**Conclusion**

It is important for plan sponsors to realize that their plans may be harboring significant and unnecessary risk from a fiduciary liability perspective if participants do not understand their plan and if their retirement savings are inadequate. By implementing the best practices described above, plan sponsors can readily help their participants prepare for retirement and help them stay on track for a financially secure future. If a plan sponsor needs assistance implementing any of these best practices, it should consider engaging a financial advisor or another qualified provider of participant education services.