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UNDERSTANDING YOUR 457(B) PLAN

Public pensions may not cover all costs in retirement. This is where the defined contribution plan comes into play to complete the retirement puzzle. These supplemental plans are powerful untapped resources that can help participants get on the right track for a fulfilled retirement. Most public sector entities offer a 457(b) plan (often known as a Deferred Compensation plan). This is similar to a 401(k) in that both types of plans are funded through employee payroll deductions, a percentage of a participant's salary goes towards their retirement account and both types retain a tax deferred status.

With a focus on "retirement readiness" in these recent years, Plan Sponsors are starting to pay attention to their governmental 457(b) plan…and many of these supplemental plans haven't been reviewed in quite some time. With this renewed interest, Plan Sponsors are now seeing the benefits of having a strong plan governance program in place. We are seeing many lawsuits arising from lack of awareness and structure in these defined contribution plans. A plan governance process gives the Plan Sponsor a sense of security and greater protection. This also leads to better retirement outcomes for participants and, therefore, is truly a win-win scenario for the plan and participant.

When a plan hasn't been reviewed over the years, several disturbing problems can arise. Some of the major areas of concern with governmental 457(b) plans are:

Many 457(b) plans are ungoverned

Ungoverned plans are those lacking employer oversight into how the plan operates. According to some leading industry service providers, there are over 10,000 ungoverned 457(b) plans in the United States. This creates inferior results for their employees and potential legal exposure for the Plan Sponsor. There are a few common characteristics associated with ungoverned plans:

- Expensive and usually non-transparent administrative fees;
- Average to high investment management fees;
- An overwhelming number of below average performing funds that are selected by the service provider; and
- Poor participant asset allocation strategies.

Many are using older contracts

Recent public plan studies conducted by Bolton Investment, reveal that Plan Sponsors with ungoverned plans are using older, more expensive contracts. Again, many of these plans have not been rebid in decades and may have never rebid. These participants are suffering from "fee drag" and are usually paying administrative fees that are much higher than the fees that can be obtained in today's market place. For these plans, a formal rebid process can usually reduce these fees by as much as 60-70%. Additionally, many of the investment expenses, are relatively high as well. Studies have shown that most of these older contracts include the vendor's own proprietary passive strategies which can be anywhere from 5-10 times greater than lower cost passive options available in the newer institutional contracts.

High fees are prevalent

Many of these plans have simply outgrown their current contracts and now qualify for lower fees. Service providers are rarely proactive offering reduced administrative fees to plans. Employers may not know that such enhancements even exist. Over a 30-year time period, a 50 basis point reduction can save a participant that is contributing $3,000 annually and earning 8%, approximately $33,575, so it's worth taking a second look at your current fee structure.

Some participants may be paying more in administrative fees. Furthermore, these fees are not equally allocated amongst participants. Within several of these older platforms, participants invested in the provider's proprietary capital preservation strategy do not pay any plan fees. Those in the variable options unknowingly pay the entire cost of administering the plan. For those who are in the variable (non-fixed) options, these higher fees can materially affect their ability to effectively save for retirement. Plan Sponsors should be aware of these fee equity issues and document their policy towards how fees are paid.

Understanding the role of the service provider

Plan Sponsors should also be aware that their service providers are not fiduciaries for the fund lineup that is offered to participants. These lineups typically contain many underperforming investment options and typically include the provider's own investment options including the target date fund series. Within these older contracts, the Plan Sponsor does not have the ability to replace any underperforming option and must wait until the provider initiates a change. Since these fund lineups contain a large number of the vendor's own proprietary funds, a potential conflict of interest may be present. Obviously, an inability to remove poor performing funds will be a detriment to a participant's ability to successfully save for retirement.

Importance of employee education

The overall effectiveness of the provider's communication and education strategy should be reviewed, as well. This area is extremely important to a plan's overall success. A participant's contribution rate is one of the most import aspects of becoming ready for retirement. There should not only be a push to get participants in the plan but also to get them properly allocated. According to the Employee Benefit Research Group, almost one-quarter of workers said they and their spouse combined have less than

$1,000 saved for retirement.1 With pension plan benefits potentially being reduced, it is important for participants to understand it's up to them to start building their nest egg for retirement, including how to best go about saving.

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How can you make the most out of your 457(b) plan?

You may be thinking, "What do I look for?", "Where do I start?" or "How will I get all of this done while trying to take care of everything else?". Implementing a governance process for your 457(b) sounds tedious but it doesn't have to be. Hiring an outside consultant to walk you through the steps can make it much less burdensome. An industry professional can put together a "Fiduciary Checklist" to keep it very simple and easy to understand. Not only that, but they can also provide fiduciary education along the way.

As a Plan Sponsor of a 457(b) plan, you are to act for the exclusive purpose of providing retirement benefits to participants. This obligation takes precedence over all other duties.2 Ensuring that reasonable fees and a streamlined investment lineup are offered to participants will significantly increase their odds of achieving their retirement goals. Remember, you only get one shot at a secure retirement. If you do it right, one shot is all it takes.