American Academy *of* Actuaries

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Retirement for the AGES Assessment

Forward Thinking Task Force

Proposal: Safe Harbor Defined Contribution Plan Under Current System

Grade: C

This assessment is based on a safe harbor single private employer defined contribution plan with the following features:

- Immediate entry into plan for eligible participants
- Auto-enrollment
- Minimum of 3% employee contributions for the match if employees do not opt out of auto-enrollment
- Safe harbor match (100% of the first 3% of compensation and 50% of the next 2% of compensation with immediate vesting)
- Default investment is life cycle/target date fund
- Auto-escalation at 1% per year until employee's elected maximum percentage (not greater than 10%) is reached.
- The employer's board of directors is responsible for governance but delegates authority for plan administration and investment to board and/or executive committees with appropriate expertise. ERISA section 404(c) can reduce some fiduciary liability.
- No subsidized early retirement or disability benefits

Safe Harbor Defined Contribution Plan Under Current System

Alignment

C-

Description

- Aligns each stakeholder's role with their skills.
- Redefines employer's role by placing responsibility for important roles with those appropriate entities.
- Helps individuals by structuring their choices to be well-defined and enhance good decision-making.
- Develops systemic ways to enhance financial security through appropriate levels of laws and regulations.

Application of Principles

+ Auto-enrollment, auto-escalation, and default investment selection as well as immediate eligibility help employees save for retirement.

+ Primary employer responsibility limited to selection of investment choices, annual contribution amount, and administration.

- Plan requires significant employee communication and education to achieve optimal outcomes. If the employer handles the communication, the expertise to effectively educate participants may or may not be available.

- Benefits are usually paid in a lump sum or rolled over to an Individual Retirement Account with limited options for lifetime income.

- Even with auto features, plan design still allows for less desirable decisions by individuals. Plan participants may not have adequate education to understand what contribution levels are sufficient to achieve their individual objectives nor how investment risk impacts the likelihood of achieving those objectives.

- Generally limited opportunities for continued contributions in the event of disability.

* The plan is managed by the employer, and relevant expertise may or may not be available.

Legend
(+) feature meets principles
(-) feature does not meet principles
(*) feature where there is not enough information to determine impact or actual impact may depend on stakeholder actions

Safe Harbor Defined Contribution Plan Under Current System

Efficiency

D+

Description

- Allows smaller plans to group together, with standard and transparent fees to lower plan costs.
- Provides consistent opportunities to accumulate assets during working lifetime to enhance participation and coverage.
- Minimizes leakage for non-retirement benefits during accumulation and payout phases.
- Encourages pooling and effective risk sharing so funds can provide lifetime income.
- Incents narrowing the variability of benefits by fostering risk hedging and allowing for pricing benefits and guarantees.

Application of Principles

+ Provides opportunities to accumulate assets during working lifetime.

+ Access to institutional pricing if employer plan is large enough.

- Single employer plans may have limited ability for pooling of risks.

- Employee bears investment and longevity risks, and the retirement income available is unpredictable.

- Significant opportunities for leakage when employees terminate from employer.

- Limited ability for smaller plans to group together for purchasing power and cost efficiency.

- Additional administrative costs are required to maintain individual accounts and provide employees with the education and tools they need to manage their retirement benefits.

Legend
(+) feature meets principles
(-) feature does not meet principles
(*) feature where there is not enough information to determine impact or actual impact may depend on stakeholder actions

Safe Harbor Defined Contribution Plan Under Current System

Governance

C+

Description

- Clearly defines roles and responsibilities, and acts in accordance with them.
- Reduces real and potential conflicts of interest.
- Recognizes and manages competing needs.
- Staffs boards with financial and other professionals who possess relevant expertise.

Application of Principles

+ Employee Retirement Income Security Act (ERISA) provides certain safeguards to participants.

+ ERISA specifies the roles and responsibilities of the governing bodies of the plan, including a provision that the fiduciaries must act in the best interests of the plan participants.

- Employees and retirees are generally not directly represented on plan governing committees.

- The needs of employers are managed; however, employers have a potential conflict of interest between their role as settlor vs. fiduciary.

* Employer has fiduciary responsibility for the plan, including selecting plan features and plan investment options, maintaining qualified plan status, etc. and making decisions that impact participants' ability to secure adequate retirement accumulations.

Legend
(+) feature meets principles
(-) feature does not meet principles
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Safe Harbor Defined Contribution Plan Under Current System

Sustainability

C+

Description

- Promotes intergenerational equity.
- Allocates cost properly among stakeholders.
- Withstands market shocks.
- Maintains balance between sustainability and adequacy.

Application of Principles

+ Costs are shared between employer and employees.

+ Relatively easy for employer to sponsor since minimal exposure to risks.

+ Intergenerational equity.

+ Employer's cost may be easily adjusted in the event of adverse business cycles.

- The flexibility within these plans that makes them sustainable may threaten the adequacy of the benefits provided.

- All investment and longevity risks are borne by employees and retirees.

- Limited ability for employees to deal with market shocks, which also impacts ultimate retirement income.

Legend
(+) feature meets principles
(-) feature does not meet principles
(*) feature where there is not enough information to determine impact or actual impact may depend on stakeholder actions

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