RETIREMENT PLAN PERSPECTIVES

Insights for Your Plan and Employees

Q1 2023

Tackling the Trend

Dealing with Inflation's Negative Effect on Employee Retirement Planning

An August 2022 survey from Nationwide Retirement Institute found that 40 percent of workers ages 45 and older plan to delay their retirement due to inflation and rising living costs. That figure is double the percentage of workers who said they delayed retirement last year due to the Covid-19 pandemic. Although the current inflationary environment presents a host of retirement plan challenges for both employers and employees, tackling the trend with prudent and sensible solutions remains the best course of action.

Inherent Costs to Employers

The 2022 Nationwide In-Plan Lifetime Income Survey indicates that 36 percent of private-sector employers say workers' delayed retirements have affected their ability to hire new talent. In addition, 34 percent of employers said delayed retirements have affected the promotion of young workers, and 35 percent said they have made their health benefits plans more expensive.

Nationwide also found employers are reporting that delayed retirements are affecting their employees' well-being. The data shows that among employers:

- 30 percent reported lower team morale
- 29 percent reported negative effects on employees' mental health
- 27 percent noticed lower workforce productivity
- 22 percent reported negative effects on employees' physical health

The study also found that only 58 percent of workers have a positive outlook on their retirement plan and financial investments, compared with 72 percent in 2021.

Potential Solutions to Consider

The survey found that 66 percent of all employees cited inflation as a top retirement concern, versus 53 percent in 2021. General education campaigns, in partnership with your plan advisor and recordkeeper, should continue to be prioritized and promoted. Focused topics for consideration include defining inflation and current contributing issues and factors, historical contexts, managing inflation risk in your portfolio, and staying the course over the long term. These topics could be supplemented with information on general financial wellness, such as budgeting and managing spending, paying down high-interest debt, and building an emergency fund.

In addition, plan sponsors may want to consider ways to further support their older workforce and improve their confidence in meeting their income needs as they near retirement. The Nationwide report shows growing interest from workers in lifetime income investment options. According to the data, 53 percent of all employees ages 45 and older are interested in guaranteed lifetime income investment options included as part of a target-date fund, compared with 42 percent in 2021; 48 percent reported they are interested in contributing to such investment options as part of a managed account; and 41 percent would likely roll over retirement savings into a guaranteed lifetime income investment option if they had the chance.

Reaching Retirement Readiness

Aided by Auto Features, Plan Participants Are on a Positive Trajectory

Being able to replace working income with income generated from retirement savings is the essential definition of retirement readiness. The percentage of working income that an individual may need in retirement will vary, depending on several factors, such as whether they will still have a mortgage, the amount of their social security benefit, their tax bracket, variable health care costs, lifestyle choices, and income from part-time work, among others.

When projecting retirement income needs, a 70–85 percent target replacement ratio is commonly cited. Recent research by Vanguard reveals that goal may be well within reach for many plan participants. The 2022 Vanguard Participant Saving Rate Index suggests that 7 of 10 DC plan participants are currently saving at rates that would enable them to attain a 65 percent replacement rate in retirement. Furthermore, its data shows that just a modest increase in participant elective deferral rates would enable most plan participants to attain a 75 percent replacement rate.

Assumptions Used

Vanguard's researchers analyzed approximately 1.9 million eligible employees and 1.5 million actively contributing participants in approximately 880 plans for which the firm serves as recordkeeper. Research modeling assumes that target saving rates are 9 percent where income is less than $50,000, 12 percent where income is $50,000–$100,000, and 15 percent where income is more than $100,000 (saving rates include both the employee elective contributions and any employer contributions). The study also assumes a 75 percent target replacement ratio, 4 percent real return, 1 percent real wage growth, 40 years of saving (from age 27 to 67), and a 4 percent withdrawal rate at retirement.

The Impact of Automatic Features

The researchers note that while some participants may not be saving at or above their target rate, many are close. Auto-enrollment coupled with auto-escalation will be instrumental in helping many participants get the rest of the way. Currently, 4 of 10 participants in the study are automatically enrolled and will see their saving rates rise 1–3 percentage points during the next few years. At this rate, the study's modeling shows that 70 percent of participants would reach a 75 percent replacement rate in retirement.

Additional Observations

Across all eligible participants in plans with automatic enrollment, employees are much more likely to be saving effectively (45 percent, compared with 26 percent in plans without automatic enrollment). As of year-end 2021, 58 percent of plans have a default contribution rate of 4 percent or higher, compared with just 32 percent of plans 10 years ago. An automatic enrollment default of 6 percent or higher was a strong predictor of participants saving effectively, along with a generous employer match. Plan size did not affect the results of the study.

Web Resources for Plan Sponsors

- Internal Revenue Service, Employee Plans: www.irs.gov/ep
- U.S. Department of Labor, Employee Benefits Security Administration: www.dol.gov/ebsa
- 401(k) Help Center: www.401khelpcenter.com
- *PLANSPONSOR* magazine: www.plansponsor.com
- BenefitsLink: www.benefitslink.com
- Plan Sponsor Council of America: www.psca.org
- Employee Benefit Research Institute: www.ebri.org

Reaching Retirement Readiness *(continued)*

Pension Plan Limits for 2023

401(k) Maximum Elective Deferral (*$30,000 for those ages 50 and older, if plan permits)	$22,500*
Defined Contribution Maximum Annual Addition	$66,000
Highly Compensated Employee Threshold	$150,000
Annual Compensation Limit	$330,000

Plan Sponsors Ask . . .

Q: Our company is growing rapidly—and so is our retirement plan. We are interested in hiring a plan advisor. When it comes to providing fiduciary support, what can we expect?

A: From a plan sponsor perspective, the act of hiring a fiduciary advisor is a fiduciary act, and one the sponsor should conduct thoughtfully. Although fiduciary services vary by advisor firm, here are the types that plans commonly use:

An advisor acting as a **3(21) fiduciary** provides investment guidance and recommendations to the plan sponsor, but the sponsor makes the ultimate decision as to whether to change the investment lineup. Because the sponsor has the final say, it also assumes the fiduciary responsibility for that decision (though it can document that the process included guidance from a professional advisor).

An advisor who acts as an **investment manager 3(38) fiduciary** also provides guidance and recommendations but makes the final decision on investments. This typically costs more and reduces the plan sponsor's involvement. Hiring a 3(38) advisor entails a deeper level of fiduciary outsourcing and fiduciary protection; they have the discretionary authority to make, vet, and implement investment recommendations.

If a plan sponsor is not an investment expert, ERISA extends the ability for them to outsource that responsibility to an investment advisor. Under the arrangement, the plan sponsor remains a fiduciary in selecting and monitoring the advisor.

Q: As part of our efforts to attract and retain employees, our plan committee is working with our plan advisor to enhance our retirement plan. We are thinking of adding lifetime income solutions. Our chief financial officer is big on data—do you have any research to help us justify the effort?

A: Workers are anxious about the effects of a potential recession on their retirement planning, which may be driving greater interest in retirement income options. The 2022 Protected Retirement Income and Planning Report says only 48 percent of workers believe their retirement savings and other sources of income will last throughout their lifetime, down from 55 percent in 2021. In addition, 70 percent said they would be able to fund basic needs in retirement, whereas only 23 percent hope to be able to fund the basics. When workers were asked if they would be able to fund "wants" in retirement, 35 percent said they will be able fund them, whereas 49 percent hope to and 11 percent said "no chance." To help further your case for adding lifetime income solutions, check out the report.

Plan Sponsor's Quarterly Calendar

April

- If a plan audit is required in connection with Form 5500, make arrangements with an independent accountant/auditor for the audit to be completed before the Form 5500 due date (calendar-year plans).
- Audit first-quarter payroll and plan deposit dates to ensure compliance with the U.S. Department of Labor's rules regarding timely deposit of participant contributions and loan repayments.
- Confirm eligible employees received enrollment information and that elections of those who enrolled were updated in a timely manner by payroll.

May

- Monitor the status of the completion of Form 5500, and, if required, conduct a plan audit (calendar-year plans).
- Issue a reminder memo or email to all employees to encourage them to review and update, if necessary, their beneficiary designations for all benefit plans by which they are covered.
- Perform a thorough annual review of the summary plan description and other enrollment and plan materials to verify that all information is accurate and current, identifying cases for which revisions are necessary.
- By May 15 (or 45 days after the end of the quarter), participant-directed defined contribution plans must supply participants with a quarterly benefit/disclosure statement and a statement of plan fees and expenses actually charged to individual plan accounts during the first quarter.

June

- Begin planning an internal audit of participant loans granted during the first six months of the year. Check for delinquent payments and verify that repayment terms and amounts borrowed don't violate legal limits.
- Confirm that Form 5500, and a plan audit if required, will be completed prior to the filing deadline or that a filing extension will be necessary (calendar-year plans).
- Review plan operations to determine if any qualification failures or operational violations occurred during the first half of the calendar year. If a failure or violation is found, consider using an Internal Revenue Service or U.S. Department of Labor self-correction program to resolve it.
- Check for any ADP/ACP refunds due to highly compensated employees for EACA plans to avoid an employer excise tax.

Consult your plan's financial, legal, or tax advisor regarding these and other items that may apply to your plan.

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Authored by the Strategic Retirement Solutions team at Commonwealth Financial Network.

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