



401(k) Investment Committee Topics

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Headline-grabbing lawsuits, large settlements, and proposed guidance offer insights as to the issues your 401(k) investment committee should be tackling. Below are four topics we recommend considering for your next 401(k) investment committee meeting agenda:

Fees are still the main topic.

Lawsuits against 401(k) plan fiduciaries continue to raise important questions to consider, such as:

- Does the plan have sufficient assets to qualify for lower-fee share classes?
- Should the plan consider offering funds that are not mutual funds, such as commingled funds that would have lower fees?
- What is the appropriate number of funds to offer?
- Should the plan offer both passive and actively-managed funds?

The recent \$30 million settlement of a 401(k) fees case against International Paper illuminates some additional issues to consider. The reported changes being made to the International Paper 401(k) plan as a result of the settlement include:

- allowing participants to transfer their assets out of company stock;
- eliminating retail mutual funds, which tend to carry higher fees;
- competitive bidding for recordkeeping services; and
- inclusion of a passively managed (index) large-cap fund

Fund selection is important too.



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Fund selection is more complex than a cost analysis. Fund management and stability matter as well. The number of funds matters, too. Too few funds means participants do not have sufficient opportunities to invest in a variety of asset classes. Too many funds means that participants might be overwhelmed or confused. Also, multiple funds in an asset class might result in the Plan's assets being so dispersed that lower-fee share classes are not available. This "dispersal" claim is a new twist on the many fee-based claims brought against 401(k) plan fiduciaries. For example, one recent complaint notes that the plan offered 36 large cap equity funds, "a bewildering array of overlapping and redundant investment choices."

Reconsider the plan's "safe" option.

Of course, no investments are completely risk-free. 401(k) plans often include a money market or stable value fund as the most conservative option. Recent events raise questions about both.

Money Market Funds

Money market funds are under pressure now for two reasons. First, the Securities & Exchange Commission has proposed new regulations related to money market funds that might make them more cumbersome for plans to offer. The SEC regulations would require most non-governmental money market funds to institute a "floating" net asset value (NAV), rounded to the fourth decimal place or to impose a 2% liquidity fee or a temporary suspension of redemptions (a "gate") if the money market fund falls below 15% liquidity. The SEC's proposal has generated concern that non-governmental money market funds may become less workable as 401(k) plan options. The obvious alternative - offer a governmental money market fund instead - may be less attractive in the current political climate. This is the second reason money market funds are under pressure. In mid-October, with the threat of default looming, some money market fund managers (such as Fidelity and JP Morgan) sold their short-term government bonds. The limited increase in the federal debt ceiling in October may prompt similar actions again in only a few months.

Stable Value Funds

Stable value funds have been under pressure since the economic downturn of 2008. Many insurers have exited, so there are fewer wrap providers and fewer stable value funds overall. And the stable value funds that remain have gotten more expensive. Still, they seem to provide returns that are modest but greater than zero, in contrast with money market funds, which have provided little if any return over the past few years.

Focus on Target Retirement Date funds.



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Target Retirement Date funds (TRDs) continue to increase in popularity as a 401(k) plan investment option. TRDs offer participants a "one-stop shopping" approach to diversification and asset allocation. The asset allocation rebalances over time, with more fixed income and less equity as the target retirement date gets closer. This is known as the glide path. Some fund families offer a static allocation at the target retirement date, and some fund families continue the glide path past the target retirement date. These aspects of the TRDs may change over time; for example, Fidelity recently announced that it would increase the equity exposure in its TRD fund family. Some questions to consider regarding TRDs:

- Does the asset class exposure and glide path make sense for the Plan population? This is important to ask at regular intervals, because a TRD fund family that made sense 5 years ago might not be the best fit today due to changes in plan participant demographics, or the TRD strategy itself may have changed.
- How are the TRDs being monitored and evaluated? The benchmark and peer group analysis for TRDs remains challenging. Most TRDs have their own custom benchmarks, and the peer group comparison is difficult because TRDs have such distinct strategies. Your committee's evaluation of TRD performance should focus not only on overall fund performance, but also the performance of the TRD's individual component funds. One criticism of TRDs is the potential that fund companies could use them to package together underperforming funds that would otherwise have difficulty attracting assets. Recent informal guidance from the DOL encourages plan fiduciaries to consider the growing number of TRD vendors that offer custom or non-proprietary TRDs that allow plans flexibility in selecting component funds.
- Does the disclosure regarding the TRDs provide participants with clear, useful information? Disclosures include the annual participant fee disclosure notice and the annual QDIA notice (assuming the TRDs constitute the plan's QDIA). Proposed DOL regulations on TRDs include some guidance on the information that should be included in these participant disclosures, including language stating that investments in TRDs may lose money both before and after the target retirement date is reached.

FOR MORE INFORMATION

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