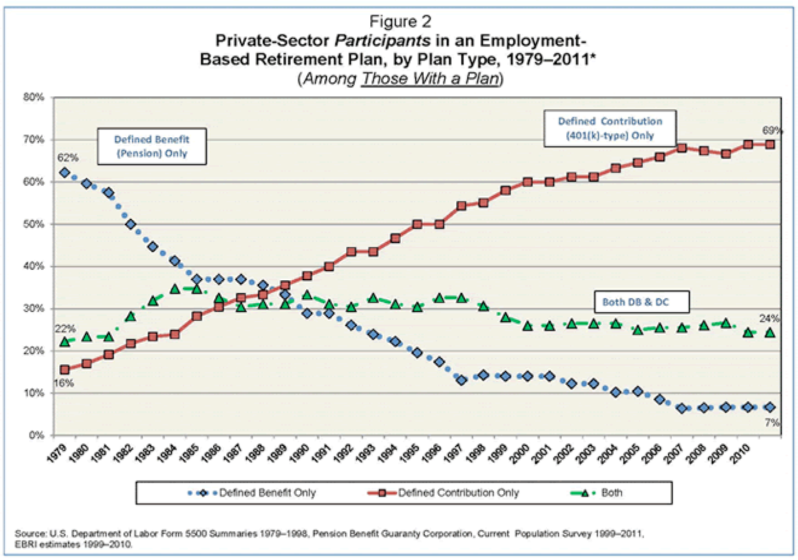
Lowe, Brockenbrough & Company

June 2014

The Changing Employer-Sponsired Retirement Plan Landscape

The Shift to Defined Contribution Plans

While many people are unfamiliar with the term Employer-Sponsored Retirement Plan, it is likely that most of us are familiar with the term defined contribution (DC) plan, more familiarly known as 401(k) or 403(b). In the early years of DC plans, many employers provided them as a supplement to traditional defined benefit (DB) plans. Only a limited number of employers offered DC plans as the only option to help employees achieve their savings and retirement goals. However, over the past 30 years, the trend in employer-sponsored retirement plans has drastically changed. As the chart below illustrates, the change from the traditional DB plan to the DC plan has been dramatic.

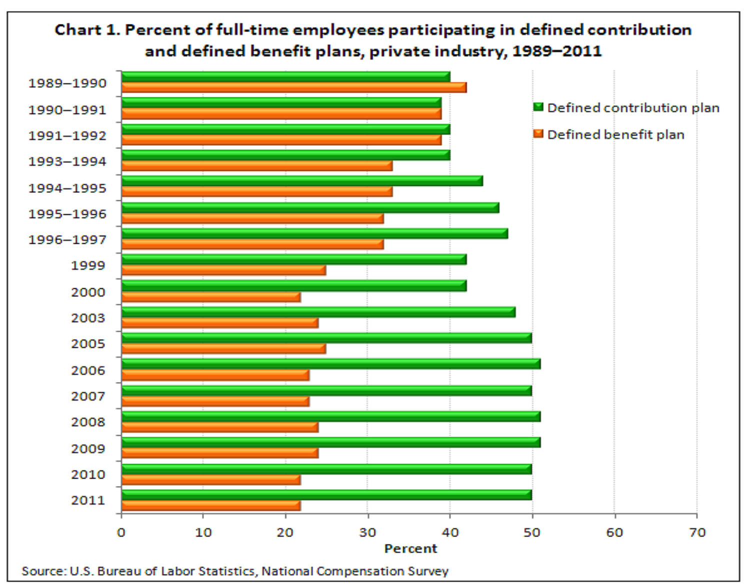


*While some sponsors have chosen to offer both a DB & DC plan, known as a "Hybrid" plan, we will focus our discussion today on the DC market place and the savings shortfalls associated with the current 401k landscape. We will discuss Hybrid plans in a future newsletter.

The Retirement Plan Participant Savings Shortfall

For the employer sponsoring the retirement plan (Plan Sponsor), the main reason for the shift from DB to DC plans was to reduce the long-term liability and financial commitment of the sponsoring firms. While the shift from traditional DB plans has provided the intended reduction in long-term financial liability to the employer, it has increased the retirement and savings responsibility on the individual employee (Plan Participant).

For retirement plan participants, this shift in responsibility has proven to be a problem. Although the number of employees participating in traditional DB plans has declined, those choosing to participate in a DC plan have remained relatively unchanged for a number of years (see chart below). The lack of DC plan participation among employees that do not have access to traditional DB plans is projected to result in a significant retirement savings shortfall. Even as the amount of savings an individual needs to accumulate to maintain their pre-retirement lifestyle continues to increase with the rising cost of Health Care and the uncertainty of future Social Security benefits, participants are not taking advantage of the DC plan benefit that employers are providing. While not participating is an obvious problem contributing to the savings shortfall, those who are participating in DC plans are still making some fundamental errors.



MFS 2013 DC Pulse Survey-DC Plan Participants' Perspectives on Risk

According to a recent DC Plan Participant survey conducted by MFS , many participants do not have a strong understanding of their appropriate asset allocation and risk tolerance. The research report revealed the following:

- Plan participants underestimate the amount they will need for retirement. According to the survey, DC plan participants estimate that $515,000 is the amount that they will need to retire. Yet, the average survey participant has saved only $84,000, with average participant retirement just twenty-one years away.

- DC plan participants have heavy weightings in conservative investments, which may not provide the growth they need to overcome their savings shortfall. Forty-one percent of plan participants identified themselves as aggressive investors, but when they were asked how they would invest a hypothetical sum of money, over a third of the respondents had a desire to invest conservatively.

- Participant attitudes varied greatly across generations. In particular, the research indicated that the most conservative and risk-averse investors were also the youngest participants.

While this information is alarming, there are several ways in which DC plan sponsors can address and hopefully correct these fundamental errors in participant behavior. First, plan sponsors need to provide their DC participants with a basic education in investing, including the importance of asset allocation and diversification. Today, more plan sponsors are adopting a formalized education strategy for their participants. Secondly, sponsors should structure a plan that allows plan participants access to a broader universe of investment options. As the responsibility of a successful retirement outcome has shifted to the plan participant, access to a larger, customized universe of investment options has become extremely important. Lastly, plan sponsors should take advantage of plan design options that address the needs of the plan and its participants. As can been seen from the survey, in many cases participants are their own worst enemy. Through proper use of plan design, plan sponsors can protect many participants from the poor decisions that will keep them from achieving a successful retirement outcome. For example, Auto-Enrollment allows plan sponsors to automatically establish a participant's retirement plan account, while the Qualified Default Investment Alternative feature enables a sponsor to invest a participant's account in a diversified portfolio, even if the participant does not proactively elect an investment option for their account.

Today's Landscape – The Fiduciary Partner

From a plan participant's perspective, today's most robust DC plans offer each participant the ability to build an investment allocation that meets their unique needs, goals, and investment objectives. These top retirement platforms provide access to an investment line-up chosen from a full universe of over 15,000 mutual funds, along with access to self-directed brokerage accounts for those participants looking for an even more hands-on experience. Along with investment flexibility, the best DC plan solutions provide ongoing investment education to help address some of the previously mentioned shortcomings of plan participants.

For the plan sponsor, the same desirable features that make the best DC plans also bring additional legal responsibility. That responsibility is known as the Fiduciary Standard. In upholding the Fiduciary Standard, a plan sponsor must act prudently and in the sole interest of the plan's participants and beneficiaries. It is this standard that governs how plan sponsors design and operate their DC plans. And, while plan sponsors can never fully absolve themselves from their fiduciary duties, they can partner with other fiduciaries to design and implement a more effective and efficient DC plan. Registered Investment Advisory Firms (RIAs), of which Lowe, Brockenbrough is one, can serve as a plan sponsor's fiduciary partner.

In this fiduciary capacity, RIAs partner with plan sponsors to address the areas that could create fiduciary exposure. Investment Advisors work with the plan sponsor to develop a custom fiduciary approach that will help them address their plan's unique needs, gain a better understanding of the organization's goals and objectives, and formulate a road map to meet those needs. Once the RIA has gained a complete understanding of the firm's retirement plan goals, a custom Investment Policy Statement (IPS) is developed that provides the basis for establishing and monitoring a recommended mutual fund line-up for the plan. In the case of Lowe, Brockenbrough, we have in place thorough due diligence and evaluation procedures that are the cornerstones of our core fund menu selection and ongoing manager evaluation. We meet with plan sponsor clients on a quarterly basis to confirm the plan's objectives, and to assure the plan's core funds are meeting participants' needs and investment objectives.

In working with plan sponsors, RIAs serving in this fiduciary role also have an obligation to help with the ongoing education of plan participants in the areas of asset allocation, plan diversification and other topics important to their retirement success. In this capacity, Lowe, Brockenbrough has developed a suite of custom asset allocation models to meet the varying investment objectives of each plan participant. These custom allocation models are based on the plan's core fund platform, and can provide a good option for plan participants in addressing the savings and allocation shortfalls that have previously hampered their desired retirement outcomes. Additionally, RIAs can assist plan sponsors in the evaluation and monitoring of the plan's recordkeeper and administrator. Lowe, Brockenbrough provides objective analyses of provider services and fees, and can facilitate the selection and implementation of plan service providers.

In serving each client in our firm's retirement services practice, we take our fiduciary role very seriously. We recognize the importance of employer-sponsored retirement plans and the impact these plans have on the successful retirement outcomes for the majority of Americans. With the increasing cost of living in retirement, it is more crucial than ever that DC plans address the needs of both the plan sponsor and its participants. We will continue to work with plan sponsors and plan participants to anticipate and adapt to the ever-changing retirement plan landscape.