Benchmarking Your Retirement Plan

Retirement programs are a critical element in designing total compensation programs for today's financial institutions. In a highly competitive employment market, benefits and compensation are critical tools in attracting and recruiting quality employees.

Retirement plans represent a substantial financial investment for employers—likely among the largest investment a bank can make to attract, retain and motivate employees. Attracting and retaining talented employees is one of the biggest challenges facing banks. Your total rewards package is the key competitive resource for employee retention. Benefits are an important component of that package. In fact, after health insurance, the most important benefit program cited by employees is a retirement plan. Maximizing that investment means designing a retirement program that meets your organization's business as well as benefit objectives.

Measuring your plan's success is more than simply evaluating plan deferral and participation rates, it includes measuring fiduciary responsibilities, the degree to which plans are in compliance, evaluating plan fees and evaluating overall plan design in terms of peer and competitive considerations.

Types of Retirement Plans

For the majority of employees, there are two types of retirement plans, defined benefit plans, which include traditional pension plans as well as cash balance plans, and defined contribution plans—401(k) plans, profit sharing plans, KSOPs and ESOPs. Defined benefit plans are what is commonly referred to as a traditional pension plans, as they are designed to provide a guaranteed lifetime income. These plans provide benefits based on a formula that takes the employee's salary and service into consideration, and typically benefit long term career employees. The employer assumes the cost and investment risk under a defined benefit plan.

401(k) plans are the most well-known and widely offered defined contribution plan. Under a 401(k) plan, the employee usually saves a portion (up to 15%) of his or her salary on either a pretax or after-tax basis through payroll deduction. Typically, the employer makes a matching contribution to provide an incentive for employees to contribute to the plan. The employee has full investment discretion, and assumes full responsibility for those investments. The plan provides an easy way for the employer and the employee to share in the responsibility of savings for retirement.

Under a profit sharing plan, employer contributions are discretionary—they are usually keyed to the existence of company profits—although actual profits are not required for a company to make a contribution. Contributions are then allocated to participant accounts according to the plan's allocation formula. At retirement, benefits are based on the value of a participant's account.

An Employer Stock Ownership Plan (ESOP) provides retirement benefits in the form of company stock. In addition to providing retirement benefits, ESOPs are frequently used as a vehicle to raise capital, create shareholder liquidity, and to keep stock in friendly hands. ESOPs allow an employer to borrow money for the purpose of acquiring employer securities, generally at an attractive price, for the benefit of the employees. As the loan is repaid with annual employer contributions, stock is allocated to plan participants.

KSOPs, or 401(k) plans with employer stock as an investment option combine the equity ownership concept of an ESOP with the savings elements inherent in a 401(k) plan. A KSOP provides many of the same benefits as an ESOP, such as raising capital, preventing unwanted takeover by placing stock in friendly hands, creating a market for stock, or refinancing bank holding company debt. KSOPs offer community banks specific advantages—the bank may make matching contributions in the form of company stock; in addition, by using employee 401(k) contributions to purchase bank stock, the corporate finance objectives of an ESOP can be satisfied at a lower overall cost.

Another Point of Consideration—Plan Compliance and Fiduciary Responsibility

Your retirement plan should also be benchmarked in terms of how well you are able to meet fiduciary responsibilities and comply with IRS and DOL regulations. Under ERISA, retirement plans are not extensions of the employer's business or organization. Plans are separate entities that must be managed solely in the interest of the plan and its beneficiaries. Under ERISA you are personally liable for each fiduciary breach—the employer's assets can not shield an individual from liability when that individual is acting as a fiduciary.

Many of the actions involved in operating a plan make the person or entity performing them a fiduciary. Using discretion in administering and managing a plan or controlling the plan's assets makes that person a fiduciary to the extent of that discretion or control. Fiduciary status is based on the functions performed for the plan, not just a person's title. A plan must have at least one fiduciary named in the written plan, having control over the plan's operation.

Fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan. These responsibilities include:

- Acting solely in the interest of plan participants and their beneficiaries;
- Carrying out their duties prudently;
- Following the plan documents;
- Diversifying the plan's investments, and
- Paying only reasonable plan expenses.

The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments. Lacking the expertise, a fiduciary will want to hire someone with that professional knowledge to carry out these functions.

Following the terms of the plan document is also an important responsibility. The document serves as the foundation for plan operations. Employers will want to be familiar with their plan document, especially when it is drawn up by a third-party service provider, and periodically review the document to make sure that it remains current.

Diversification—another key fiduciary duty—helps minimize the risk of large investment losses to the plan. Fiduciaries should consider each plan investment as part of the plan's entire portfolio.

What Potential Liability is Involved?

With fiduciary responsibilities, there is potential liability. Fiduciaries may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of the plan's assets resulting from their actions.

Understanding fiduciary responsibilities is important for the security of a retirement plan and compliance with the law. Who is a plan fiduciary? Essentially, a plan fiduciary is anyone who exercises discretionary authority over plan assets, who gives investment advice for a fee, or who has some discretionary authority. There are two ways to become a fiduciary—by appointment or by the performance of a fiduciary function. In fact, by virtue of normal interaction with the plan you may be a fiduciary and may not even be aware that you are one.

One of the more critical fiduciary duties is to completely understand plan fees and expenses, in terms of who bears the cost of plan fees and how fees are paid. Plan fees can range from administrative charges for plan services to investment fees and sales charges, including commissions, 12b-1 fees, brokerage account fees, investment fund loads (front end, back end, contingent deferred sales charges (CDSC), wrap fees and investment advisory fees. Fees also can include transaction charges paid by the individual participant.

Plan Design Features—How Does Your Plan Compare?

Another component of evaluating your retirement plan effectiveness is based on plan design features. Does your plan participation compare favorably against industry standards and your goals for your plan? Typically, plan success is measured in terms of participation rates, deferral rates and overall asset allocation. Beyond these factors, consider whether your participants contributing at a rate that will meet their retirement goals for financial security, whether plan participants are receiving sufficient education to understand the provisions of their plan and the investment opportunities available under the plan, and whether plan education strategies are aligned with your plan's demographics.

Designing an effective retirement program means not only developing a plan that assists employees in meeting their retirement goals, but also addressing your organization's business needs. All community banks share a similar goal—to attract and retain valuable employees in order to provide a high level of customer service that will enhance the growth and profitability of the institution. Retirement plans remain one of the most effective ways to do so.

Ready to benchmark your retirement plan? Contact the Pentegra Solutions Center at solutions@pentegra.com or 855-549-6689.

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