Why Employers Need to Care About Employees' Financial Health

If your employees are financially stressed, they could be hurting your business. Here's how to help.

BY MARK J. GILBERT, CPA/PFS, MBA

We regularly hear how low levels of retirement and emergency savings, and the trillions of dollars in student, credit card, and other personal debts held by Americans are threats to our economy — the next shoe to drop, some say. So, it should be no surprise that more than half of employees are financially stressed, according to PwC's 2018 Employee Financial Wellness Survey, and it's taking a toll on their productivity and happiness in and out of the workplace. That's not good news if you're an employer. But as an employer, or an advisor to one, you're in the unique position to help employees tackle these issues. Employer-sponsored defined contribution plans can do a lot in securing the financial success of employees and employers — if they're implemented right.

Business owners want to see the best ROI out of every dollar invested in employee-related costs. One area often overlooked is defined contribution plans, like 401(k) and profit-sharing plans. For both employers and employees to get the most out of these benefits, they must be designed, managed, and promoted with care. So, here are some best practices for plan design, management, investment selection, employee participation, and participant education to help set businesses and their employees on a more sustainable financial track.

DESIGN

An effective plan starts with the right design. The first and most important step in establishing a defined contribution plan is for employers "to consult their accountant or tax advisor to determine plan goals and the tax implications different types of plans can have on their company and an owner's personal taxes," says Jeffrey Hommel, AIF®, vice president of Retirement Plan Solutions at TD Ameritrade Institutional.

For example, if maximizing growth of the business owner's defined contribution plan is the goal, it might be appropriate to establish an age-weighted and/or cross-tested plan that allocates greater employer contributions to the oldest, most highly compensated employees. However, doing so will likely come at a cost. Younger employees may be deterred from participating due to their smaller contributions, and higher administrative costs can negatively impact participation and discrimination testing.

That said, there are ways to mitigate these impacts. For instance, a profit sharing and 401(k) survey released in 2016 by the Plan Sponsor Council of America (PSCA) indicated that 57 percent of plans employ a beneficial tactic: automatic enrollment. Automatically enrolling employees in defined contribution plans increases participation,

especially among lower-compensated employees, thus helping business owners with discrimination testing and contribution limits.

The takeaway here is that it's critical to think of all the minutiae when trying to offer and implement a successful defined contribution plan.

MANAGEMENT

"It's critical that employers understand the fiduciary obligations associated with offering a retirement plan. Most plan sponsors don't realize they are personally liable for the plan and that the 'corporate veil' does not exist," Hommel says.

The role of the employer plan sponsor as fiduciary is described in ERISA, but a good way to help meet fiduciary responsibilities is to create and manage defined contribution plans through the following documents:

- **Summary Plan Description (SPD),** which is written primarily for plan participants and describes the main provisions of the plan, including eligibility, vesting, contribution rules and limits, distributions and other withdrawals, and procedural rules.
- **Committee Charter (CC),** which describes the purpose, membership, and operational rules of the employer-related entity overseeing the operation of the plan.
- **Investment Policy Statement (IPS),** which addresses the processes for selecting and maintaining the investment choices available to plan participants.

INVESTMENT SELECTION

Over the years, employers have collectively gone from offering too few investment vehicles in their defined contribution plans (sometimes as little as two funds), to far too many investment choices (literally, more than 100 funds).

Today, it is a best practice to focus less on the number of investment choices and more on the nature of the plan's participants. Employees will fall into different categories as far as comfort, interest, and skill in picking investments. Here's what I recommend depending on employee interest and sentiment towards managing their investment choices:

- **Little or no interest:** Offer several actively managed target-date funds, each corresponding to varying retirement dates in approximately five-year intervals.
- **Some interest:** Provide a mix of quality, low-cost actively and passively managed funds in broad asset class categories. Think stable value, fixed income, U.S. large-, mid-, and small-cap equities, international equities, and some alternative investments.
- **Maximum interest:** Consider providing a self-directed investment option through a linked brokerage account, which would grant participants the greatest freedom in investment choices and strategies.

EMPLOYEE PARTICIPATION

A strong employee participation rate (the percent of eligible employees who actively contribute to a defined contribution plan) is important for a number of reasons: it helps business owners and other highly compensated employees with discrimination testing because it improves participation among the non-highly compensated employee workforce; it means that a meaningful number of employees are meeting the challenge of preparing for their own financial security; and it can drive down administrative costs, among other reasons. Unfortunately, many employees with access to employer-sponsored defined contribution plans never participate or never maximize the true benefits. Some of the best practices to increase employee participation are:

- **Automatic enrollment:** Employees automatically participate in the plan unless they opt out. According to a recent Vanguard report, automatic enrollment inspires higher participation rates across all demographic variables (83 percent versus 58 percent for plans with voluntary enrollment). However, automatic enrollment requires the employer to select a default contribution rate (typically 3 percent of pay) and investment choice (generally a relevant target-date fund).
- **Matching contributions:** The PSCA survey demonstrated that plans offering employer-matched contributions have better participation rates. The most common match was $0.50 for each $1.00 in employee contribution up to 6 percent of employee compensation.
- **Online plan resources:** Plan vendors who provide easy, intuitive app and/or web-based options for changing contribution rates, moving balances between investments, researching investment options, and requesting withdrawals report stronger participation rates than in plans where online functionality is unavailable or difficult to use.

PARTICIPANT EDUCATION

Financial literacy is empowering. Anytime an employer offers a defined contribution plan, it's a good idea to invest in participant education tools. First, there's a legal and fiduciary responsibility to educate participants about any investment choices available to them. But, there's also a disconnect between worker perceptions and reality.

A 2018 study by the Employee Benefits Research Institute indicated about 80 percent of workers surveyed expect their retirement plan to be a source of retirement income, and 50 percent say it will be a major source. Unfortunately, U.S. News & World Report recently reported the median retirement plan account balance for working age participants is just $3,000 and $12,000 for participants approaching retirement — clear shortfalls in the amounts needed for a secure retirement by any definition. Taken together, these statistics indicate that employees expect their retirement plans to produce at least reasonably large account balances but are failing to take the steps to make that happen.

Simply put, many employees lack the education to fully take advantage of employer-sponsored defined contribution plans. So, to all of you employers out there, I'll leave you with some homework to help ensure you're offering real financial benefits to your employees and that they're fully taking part in securing their financial futures:

1. Define each objective of any participant education program you intend to offer: Pass discrimination testing? Increase employee participation or contribution rates? Improve employee satisfaction? Assist participants in planning for long-term financial security?
2. Review and evaluate current participant education materials considering all stated objectives: Are the education tools addressing the objectives?
3. Design or redesign your participant education program: Identify the topics to cover, and determine the methods of communication (group meetings, in-person sessions, online, video, print, a part of other company communication tools, etc.).
4. Incorporate education, to the extent possible, on broader issues regarding overall financial wellness to make the information more meaningful to a greater number of employees.
5. Implement the program.
6. Evaluate the program.
7. Update and periodically repeat these steps in the future.

As an employer, or an advisor to one, you have a responsibility to ensure the financial success and sustainability of an organization that impacts the livelihoods of many. Your employer-sponsored defined contribution plan is a key part of that effort, so invest the time in a proper implementation. It'll pay greater dividends to all.

Reprinted courtesy of INSIGHT, the magazine of the Illinois CPA Society. For the latest issue, visit www.icpas.org/insight.