

The Quest for Excellence in Higher Education Retirement Benefits: Improving the Design and Administration of Defined Contribution Plans

Public and private universities, colleges and other higher education institutions are joining the ranks of employers who are taking a closer look at the design and administration of their defined contribution retirement programs. This “closer look” is a response, in part, to growing recognition that these plans are a vital part of a total rewards and compensation policy that must be flexible and comprehensive enough to address the challenges of serving a diverse workforce that may include teachers, researchers, administrators, clerical and service employees and, in many cases, health care professionals.

High-profile events of the past few years have also heightened scrutiny of defined contribution plans. Given volatile financial markets, pension reform legislation and increased regulatory oversight, litigation and investigations, it is no surprise that higher education, hospitals and other not-for-profit employers are grappling with more complicated decisions to sustain and enhance defined contribution plans supportive of employees seeking empowerment and choice in retirement plan design. It is important to note that although most plans are not fundamentally “broken,” the challenge is to achieve a maximization of benefit for the employee population and return on investment for the employing institution while keeping up with evolving rules, regulations and compliance requirements under the law. For this reason, all plans

should be reexamined periodically to ensure their effectiveness and efficiency in meeting these overall objectives.

Higher education institutions are also realizing that their plan participants do not fully understand the plan, how to evaluate investment options and fees, and the importance of diversification and rebalancing over time. Finally, publicity surrounding retirement plans and the recently enacted pension reform legislation is also contributing to the concerns about the appropriateness of current plan designs and oversight. Together, these developments should suggest to colleges and universities that the timing is right for comprehensive and strategic reviews of their defined contribution plans.

Of course, conducting such a review should not be viewed as “crisis-driven” activity. In fact, periodic regular reviews are part of the due diligence that plan sponsors should be undertaking as part of their regular and ongoing fiduciary responsibilities. For example, a review could lead to the negotiation of improved contract terms from service providers that can yield meaningful savings or reduced investment-related fees that will enhance earnings on participants’ assets.

There is also an important human resources reason for conducting regular reviews: Ensuring employee satisfaction with a defined contribution plan and maximizing the value it delivers helps with recruitment and retention. Employee satisfaction with a defined contribution plan is also material to workforce management in the higher education market, where faculty are tenured and mechanisms to encourage voluntary retirement are rare.

Finally, because the defined contribution retirement plan investment

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and administration marketplace is constantly evolving, employers are encouraged to take a fresh look from time to time at their plans’ investment offerings¹ and vendors to make sure that they remain competitive with the best investment alternatives and services currently available. Plan sponsors should consider developing a formal review process.

CONSIDERING COMMON CONCERNS ABOUT CURRENT HIGHER EDUCATION DC PLAN DESIGNS

It is becoming increasingly clear to employers in higher education that much can be done to make their defined contribution plans work more effectively and efficiently. Often in higher education the problem is the number of plans being offered without active management. Higher education institutions may sponsor a variety of Internal Revenue Code defined benefit and defined contribution plan types, including §401(a) qualified plans, §401(k) plans, cash or deferred arrangements, §457 deferred compensation

¹ For §403(b) plans not subject to Title I of ERISA, checking investment options is not a fiduciary duty; however, many sponsors are reexamining whether there is value in taking on an active monitoring role and accepting the resulting fiduciary responsibilities.

plans and, of course, the traditional §403(b) tax-sheltered annuity (TSA) programs.

Historically, most higher education institutions have taken a relatively passive approach to managing the §403(b) and §457 components of their retirement benefit programs. Part of the reason for this “hands-off” approach relates to the desire to avoid taking on the perceived risks and liability of being a “fiduciary” with regard to these plans. As a result, the defined contribution plan structure for many higher education institutions often has the following major elements:

- Multiple service providers offering similar or duplicate investment products, options and services,
- Investments provided through higher cost individual or group annuity products, which contain additional mortality and expense charges,
- Investment contracts subject to substantial initial sales costs for brokers and agents and/or contingent deferred sales charges, and
- Transfer restrictions or penalties if participants want to move to different investment providers or options.

SHAPING UP DC PLAN DESIGNS

The first step of a defined contribution plan review involves looking at plan design, particularly the extent to which each plan may be expected to contribute toward meeting the employer’s retirement objectives, and eliminating offerings that are either not doing so or are redundant. Without stated plan objectives or a retirement philosophy statement to determine or measure the effectiveness of the current defined contribution plan design, it will be impossible to determine whether a plan remains consistent with the

employer’s overall benefits strategy (e.g., encouraging retirement savings, supporting recruitment and retention efforts, empowering employees to make choices, increasing employee affinity and loyalty and tax-leveraging of contributions).

The following criteria should be considered in measuring the effectiveness of plan design:

- The purpose of the plan and its “fit” with the employer’s total compensation strategy,
- Participation rate and breakdowns,
- Effective savings rate,
- Funding vehicles,
- Appropriateness of investment options and selection process,
- Participants’ investment decisions,
- Features (e.g., automatic enrollments, Roth contributions, loans, hardship distributions and self-directed brokerage windows),
- Participant education services and investment advice, and
- Competitiveness.

The extent to which deficiencies are identified in any of the above areas will generate opportunities for consideration of plan design alternatives focused on more effective alignment with organizational objectives.

REVIEWING PLAN PERFORMANCE

A thorough review of a defined contribution retirement plan’s performance covers participant satisfaction, investment performance, vendor fees and vendor service.

Determining Participant Satisfaction

Employee feedback is important. Participants can be surveyed about the selection of investment choices, service, hours of operation, technology and education. In addition, eligible non-participants could be asked for details about their decision not to make deferrals.

Checking Investment Options

When fiduciary duties demand or otherwise, as may be deemed appropriate by the plan sponsor, checking investment options is one step in the review process that should be performed *at least annually*. This step entails reviewing conformance with the plan’s investment policy statement that outlines, among other things, the investment line-up, parameters for participant direction, which benchmarks and peer groups will be used and the basis for removing or replacing existing investment options.²

Examining Vendor Fees

Examining vendor fees is not as straightforward as it might seem. In addition to considering the reasonableness of the administrative, investment and other fees, employers should seek to uncover any “stealth costs.” For example, the plan’s investment options may contain so-called “12b-1 fees.”

These are additional fees that certain mutual funds use to help pay for the distribution and sale of their products. Typically, they are set as a percentage of the total fund expense. Generally, the fees are paid through participant earnings, reducing investment returns. The employer should understand how these fees are being used (e.g., to pay for agent or broker services or distribution and marketing charges) and, if the fees are reasonable, how these should be reflected in plan earnings.

Identifying the “Right” Funding Vehicle to Use

The most advantageous funding vehicle for investing plan assets will depend on a variety of factors, including the type of plan and the range of services to be provided to

² Every retirement plan — other than §403(b) plans not subject to Title I of ERISA — should have a formal statement of investment policies and guidelines that should be reviewed and updated periodically.

participants. Section 403(b) TSA plans are traditionally funded through insurance annuity products. These can be more expensive in some cases because of mortality and expense charges and may be subject to substantial restrictions on the ability of the plan sponsor and the participants to move plan assets to new funds or investments. In many cases, it may be possible to eliminate transfer restrictions and to decrease deferred sales charges through negotiation with the current provider or by using other non-annuity funding vehicles, such as §403(b)(7) mutual funds.

Assessing Vendor Service

Make comparisons with what ahead-of-the-curve vendors are offering. Examples include:

- Technology that enables employee self-service, such as Web-based access to account management, quarterly statements and annual benefits reports and includes a participant-education component or investment advice service offering,
- Multifaceted high-tech and “high-touch” approaches to communications, including personalized benefit statements and electronic information, “investing 101” and other investment education workshops and preretirement-planning assistance with a financial professional,
- State-of-the-art reporting regarding participant behavior, and
- Connectivity with the employer’s human resources information system for ease of reporting and updating functions.

Vendor administrative services should be subject to both qualitative and quantitative formal performance standards established in the same way as investment guidelines and objectives. Once the desired core vendor services are identified, the review should enable the plan sponsor to evaluate the vendor

in terms of how effectively each service is being provided.

The sample report card below shows how the priorities of two institutions of higher education might result in different “grades” for one vendor. (When using this report card, which takes into account employers’ priorities, the higher the vendor’s score, the better a match it is for an employer.)

ACTING ON REVIEW RESULTS

After a review, plan sponsors generally have several courses of possible action depending on the findings, including but not limited to the following: redesign of the plan structure, redesign of the investment structure and/or placing vendors on notice of any service, cost or product shortcomings. In addition, it may be necessary to renegotiate vendor service contracts or conduct a search for a new vendor.

Streamlining the Number of Service Providers

A key issue affecting the potential for success of any redesign proposal is the

extent to which each higher education institution is able to streamline the number of vendors servicing its defined contribution plans. The ability to achieve cost and administrative efficiencies will be dramatically enhanced to the extent that the plan sponsor is able to adopt a policy that limits the number of vendors. The ability to move to a single administrative and recordkeeping platform, in particular, is vital to be able to deliver a defined contribution plan that effectively integrates all the major benefits, administrative, communication, education, enrollment, investment and participant service functions of the plan.

Renegotiating Contract Terms

The first step after a review should always be to talk to the current vendor to see what can be improved. The plan sponsor has to ask for these improved contract terms.

Even after a contract is negotiated or renegotiated, improvements can be made. A common mistake that plan

A SAMPLE REPORT CARD: ONE VENDOR AND TWO PLAN SPONSORS’ PREFERENCES

A1 RECORDKEEPING SERVICES, INC.					
Core Service Areas*	Rating	Sample University's Weighting**	Score	Sample College's Weighting**	Score
Compliance	3	5	15	0	0
Participant and Plan Sponsor Fees	3	10	30	10	30
Financial Strength	4	5	20	0	0
Investment Management/ Performance	4	30	120	20	80
Member Services/ Communication/Education	4	10	40	15	60
Organization and History	5	5	25	0	0
Plan Sponsor Services/ Quality Assurance	5	10	50	10	50
Recordkeeping/ Transaction Services	3	10	30	20	60
Technology and Systems/ Reporting	3	10	30	25	75
Trust/Custodial/ Fiduciary Services	4	5	20	0	0
Total Score***			380		355

* The core service areas are listed in alphabetical order to avoid suggesting that there is any order of importance.
** This report card requires plan sponsors to select weights for the core service areas that total 100.
*** In this report card, the maximum possible total score for any service provider is 500 points.
Source: Segal/Sibson, 2007.

sponsors make is to assume that they cannot expect services that are not outlined in their contract. On the contrary, vendors will usually do more for employers than their contracts specify *if* the employers request changes.

Conducting a Search

If the negotiations are unsuccessful or negotiations are not pursued because the vendor’s “report card” marks were poor in critical areas, the employer should conduct a competitive bid for a new vendor. At a minimum, the process will help benchmark administration fees and services.

It is important to note that the decision to switch to a new vendor should not be made lightly. The process of switching can be fraught with problems, yet the transition must be seamless to participants. Moreover, the “blackout” period, during which investment changes cannot be made while the vendor switch occurs, should be kept as brief as practicable — and should only begin after notice is provided to participants. Because selecting a new vendor and making a smooth transition can be difficult, professional assistance can be helpful.

KEEPING UP TO SPEED

The plan sponsor’s role should not end once a renegotiated contract takes effect or a new vendor takes over plan administration. There is an ongoing fiduciary obligation to monitor the vendor.

The quarterly investment report that most service providers send to plan sponsors contains a wealth of information that can help in monitoring vendor performance. Too few employers know how to make full use of quarterly investment reports. But plan sponsors should also be careful to read the vendor-provided reports with a critical eye and should judge performance on the basis of independently established standards.

The administrator’s statistical report is an additional source of important information. It can show the employer how employees are using the plan, including deferrals and investment allocations, by demographic groups.

Another helpful tool is the plan administration guide. The employer and the vendor should update this document as often as necessary. Far too often, vendors are slow in updating internal plan administration guides to reflect changes in the plan or federal law.

EDUCATING EMPLOYEES

Well-thought-out communications can contribute to the success of a defined contribution retirement plan. In response to lower-than-desired participation or savings levels, employers should be reviewing their communication efforts to determine what is appropriate for their employees.

CONCLUSION

Making sure a defined contribution retirement plan and its vendor measure up to the best competition requires undertaking systematic, regular reviews. Recent legislative and regulatory actions recognize the shortcomings and cast doubts on the effectiveness of a “hands-off” management policy for defined contribution plan design and administration to meet both employer and employee retirement benefit objectives. Some employers in higher education are beginning to abandon the long-held notion that these plans — particularly their §403(b) TSA plans — can operate efficiently and effectively without active governance and are beginning to recognize that employer oversight is crucial. The emerging climate, coupled with ongoing activity in Washington concerning defined contribution

retirement plans,³ suggest that the time to start the review and redesign process may be now.



This publication was prepared with assistance from Segal Advisors, Segal/Sibson’s investment-consulting affiliate. For more information about reviewing defined contribution plans and vendors, contact your Segal/Sibson consultant, the nearest Segal/Sibson office or the following expert from Segal/Sibson’s Higher Education Practice:

➤ *Kelly Jones*
216.687.4434
kjones@sibson.com

³ The IRS enforcement initiative is compelling colleges and universities to pay attention to the structure and administration of the §403(b) programs that they had traditionally ignored in the hope that they were not the employer’s responsibility.

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