



## Changes in Employee Demographics May Impact Owner's Percentage of Retirement Plan Contributions

A common goal for successful business owners when designing a retirement plan is to provide a reasonable benefit level to their employees while maximizing the benefits to themselves. Most times this is accomplished with an aged-based or "cross-tested" design that allocates differing contribution levels based on an employee's class.

It is important to understand that changes in your clients' employee demographics from year to year may have a dramatic effect on the allocation of contributions. Even the addition or termination of one employee may reduce the allocation to the business owner or require an increase in contributions for the staff.

Consider this situation: A business with 10 employees designed a plan in which the owner and his spouse were receiving approximately 89 percent of the total contributions. The following year the business lost one of the younger employees. The allocation percentage for the owner and spouse went down to 70 percent.

What should plan sponsors do?

Be aware that changes in employee demographics can impact the owner's percentage of the plan contributions. If you have questions about the addition of new employees to the plan or existing participants leaving the plan, please contact your plan consultant.

*This article was based on a publication written by PenSys.*

## Index Funds – Passive or Passive Aggressive?

One of the largest misconception about index funds is that their only distinguishing feature is their fees. It's not uncommon to hear, "index funds are just holding the stocks or bonds in the index, so we don't need to pay attention to them." This assumption, however, is an oversimplification. Many investors don't realize that all index funds are not created equally.



A key difference between indexes and index funds is that index funds are exactly that – funds. Index funds manage obstacles that indexes themselves don't face. The largest is that funds actually must transact in securities whereas indexes do not.

As an example, when Standard and Poor's recently added Coty (COTY) to the S&P 500 Index to replace Diamond Offshore Drilling (DO), S&P simply recalculated the index values based on the closing prices of the securities on the effective date. Index funds that track the S&P 500, however, had to sell out of their positions in DO and purchase COTY, PLUS rebalance the weightings of any remaining securities

that were impacted by the change. Trading in these securities exposed the funds to transaction costs such as commissions and market impact. Additionally, funds face the risk that their realized trade prices on the securities may be different than the values used to calculate the index, creating a difference in performance. In this example, the impact of these factors is generally small.

Where the impact is more meaningful is in areas such as fixed income and international equities where liquidity in the securities tends to be significantly lower, there are more securities in the indexes, and changes are more frequent. The Barclays Aggregate Index, for example, has over 8,500 securities in it, with many of them not trading every day. In addition, the index rebalances on a monthly basis, so managers tracking this index must constantly adjust the fund.

Index funds must also efficiently manage flows in and out of the funds, dividends and interest payments, mergers, tax consequences and securities lending – all challenges that the underlying indexes do not face.

Fortunately, most index managers are adept at keeping their funds in-line with their benchmarks, so the impact of these factors on fund performance is generally small – small, but important. Just like active funds, evaluating index funds requires careful analysis beyond fees and should also include performance and risk. The index fund metrics in the Scorecard System™ incorporate all of these, providing a complete picture of the factors that produce the most effective index funds.

### Allowable Plan Expenses: Can the Plan Pay?

The payment of expenses by an ERISA plan (401(k), defined benefit plan, money purchase plan, etc.) out of plan assets is subject to ERISA's fiduciary rules. The "exclusive benefit rule" requires a plan's assets be used exclusively for providing benefits. ERISA also imposes upon fiduciaries the duty to defray reasonable expenses of plan administration. General principles of allowable expenses include the following:

- The expenses must be necessary for the administration of the plan.
- The plan's document and trust agreement must permit use of plan assets for payment of expenses.
- The expenses must be reasonable and incurred primarily for the benefit of participants/beneficiaries.
- The expense cannot be the result of a transaction that is a prohibited transaction under ERISA, or it must qualify under an exemption from the prohibited transaction rules.

In light of today's plan fee environment, it is incumbent upon fiduciaries to request full disclosure of fees and expenses, how they breakdown with services provided, as well as a request for full explanation of who will be the recipient of fees. Ultimately the ability to pay expenses from a plan trust is a facts and circumstances determination that needs to be made by plan fiduciaries. Because it is possible that the Department of Labor may challenge such determinations it is important that fiduciaries consult ERISA counsel prior to paying questionable expenses from a plan trust and document the decision and reasoning. For more information on this topic, please contact your plan consultant.

### Communication Corner: 2017 Retirement Plan Limits

This month's employee memo provides participants with the cost of living adjustments affecting dollar limitations for pension plans and other retirement-related items for tax year 2017.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase ([fiduciarybriefcase.com](http://fiduciarybriefcase.com)).

Call or email your plan consultant if you have questions or need assistance.

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S&P 500 Index is an unmanaged group of securities considered to be representative of the stock market in general. You cannot directly invest in the index.

Performance of indexes reflects the unmanaged result for the market segment the selected stocks represent. Indexes are unmanaged and not available for direct investment.

The B3 Provider Analysis™, RPAG's proprietary retirement plan fee benchmarking and request for proposal (RFP) system, utilizes live-bid benchmarking to provide a comprehensive benchmarking of a plan's fees, services and investments in one robust report.

International investing involves special risks such as currency fluctuation, lower liquidity, political and economic uncertainties, and differences in accounting standards.

The value of fixed income securities may fall when interest rates rise. Fixed income securities with longer maturities tend to be more sensitive to changes in interest rates, usually making them more volatile than fixed income securities with shorter

maturities. For all bonds there is a risk that the issuer will default. High-yield bonds generally are more susceptible to the risk of default than higher rated bonds.

Please note that all investments are subject to market and other risk factors, which could result in loss of principal.

Mutual funds are sold by prospectus only. Before investing, investors should carefully consider the investment objectives, risks, charges and expenses of a mutual fund. The fund prospectus provides this and other important information. Please contact your representative or the Company to obtain a prospectus. Please read the prospectus carefully before investing or sending money.

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