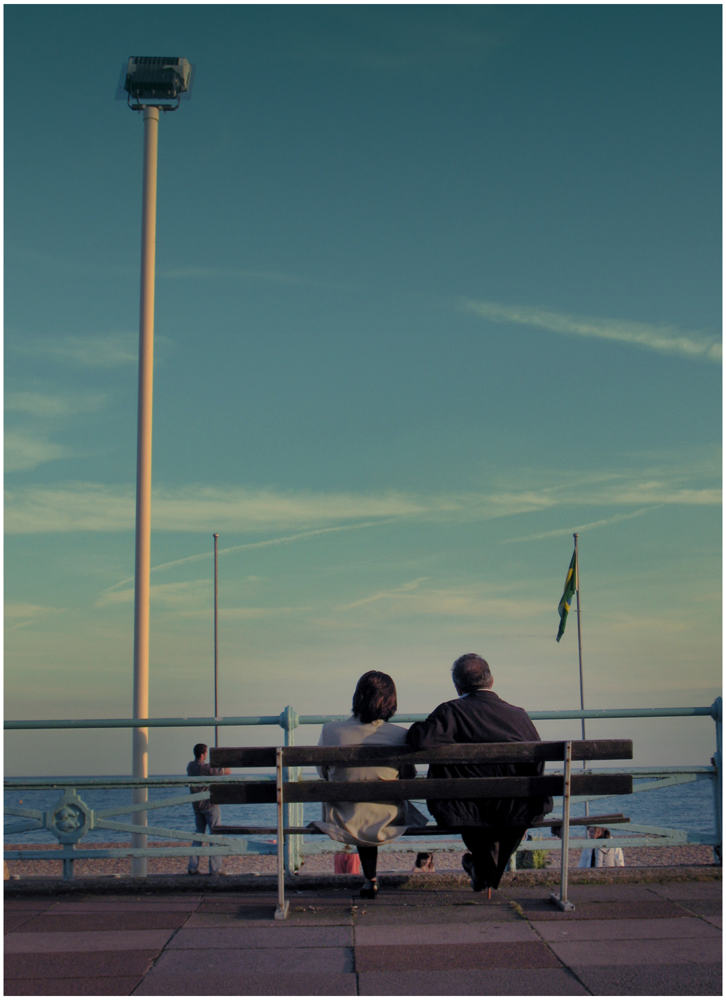
HERITAGE INSTITUTIONAL

RETIREMENT Report

DECEMBER 2014 *News and updates for plan sponsors and fiduciariesof defined contribution plans*

CASE STUDY: AUTOMATIC ENROLLMENT REVISITED



Eight years have passed since the Pension Protection Act of 2006 virtually blessed automatic enrollment for defined contribution plans. Has automatic enrollment turned out to be the panacea intended?

In 2007, a financial services center whose plan participation languished below 50% began working with a retirement plan firm. Since the client had multiple branch offices of minimum wage-earning employees for whom English was a second language, it was difficult to meet effectively with everyone to encourage participation. As a result, the plan decided to add automatic enrollment with a default deferral at 1% into a target date fund. Participation, which started at 49% in 2007, ballooned to a whopping 84% just one year later.

The plan fiduciaries were so encouraged by the success, they subsequently increased the default rate to 3% and included a sweep of all current employees contributing below the 3% threshold. Participation today holds steady at a proud 86%. In addition, the plan's former nondiscrimination testing woes have all but disappeared as the plan passed its nondiscrimination test each of the last four consecutive years.

Automatic enrollment works.A plan fiduciary committed to increasing plan participation and passing the nondiscrimination testing will adopt automatic features. Contact your plan consultant to discuss how these important design features will enhance your plan.

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PENSION PROTECTION ACT OF 2006 RESTATEMENTS

If your retirement plan document is a "pre-approved" document (prototype or volume submitter), every six years you are required to restate your plan. Your last required restatement was likely your EGTRRA (Economic Growth and Tax Relief Reconciliation Act of 2001) restatement.

And it's time for restatement again.

The present restatement window is being referred to as the Pension Protection Act of 2006 (PPA) restatement. The restatement is meant to update your document to incorporate that piece of legislation along with the following:

Final 415 Treasury regulations:

- The Katrina Emergency Tax Relief Act of 2005 (KETRA);
- The Gulf Opportunity Zone Act of 2005 ("GOZone");
- The Heroes Earnings Assistance and Tax Relief Act of 2008 (HEART); and
- The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA).

Because your plan document is required to be restated, now is a good time to also reexamine all of your existing plan design provisions. Perhaps your document, as it presently exists, has historical provisions that no longer reflect your plan's demographics, your company's retirement plan goals, or you wish to make your plan more dynamic. The optimal course of action would be to fold these plan design changes into a required restatement. The current restatement must be completed by April 30, 2016.

Failure to restate your plan jeopardizes its qualified status. If a plan loses qualified status it results in a loss of deductibility of contributions for you, the employer, and employees' vested account balances would become immediately taxable (and ineligible for rollover to another qualified plan or IRA). If the plan is restated after April 30, 2016 it must file as a late amender in the IRS's Voluntary Correction Program (with attendant fees . . . ranging from $750 - $5,000).

All that's likely left to do is for you to discuss any potential plan design changes desired with your plan consultant and service provider, have the document's specific provisions selected to reflect your specific plan and have the document executed.

Your plan provider has already begun the process by having their prototype and volume submitter documents submitted to, and approved by, the IRS for opinion or advisory letters. In other words, the form of your plan's restatement has already been designed and likely approved by the IRS. All that's likely left to do is for you to discuss any potential plan design changes desired with your plan consultant and service provider, have the document's specific provisions selected to reflect your specific plan and have the document executed.

DESPITE NOISE, MACRO FACTORS WILL DRIVE FIXED INCOME MARKETS

All eyes in bond land have been focused on Newport Beach, California, since Bill Gross on September 26 announced he was departing for another firm after 40 years at the helm of PIMCO. Given Gross's position as the highly visible CIO of the world's largest bond manager, the market's fixation on his decision — and the impact it may have on fixed income dynamics as PIMCO contends both with fund outflows as well as with potential adjustments to its portfolio positioning — is understandable. And while all this makes for interesting bond desk chatter, fixed income markets continue to be driven primarily by much more impactful fundamental and technical factors, both on the western front and well east of PIMCO HQ.

DESPITE NOISE CONTINUED

Global Interest Rates

Macro backdrop. U.S. economic data continues to surprise to the upside. Though each upbeat data point out of the U.S. going forward has the potential to draw forward market expectations of the Fed's timing, we continue to believe the central bank will hold off on its initial fed funds rate hike until mid-2015, at which point it will steadily raise rates over time to the 2.0-2.5% range before taking a breather. While the U.S. economy is exhibiting the type of cyclical strength that should bias short- term rates higher and the dollar stronger, the Fed's consistently dovish messaging — relative to its more- hawkish "dot plot", which depicts the interest rate projections of individual FOMC members — is stifling the rate move, as broader structural factors are keeping inflation readings below target. For example, while September nonfarm payrolls came in stronger than expected and were accompanied by upward revisions to July and August, wage growth remains moribund, as evidenced by flat average hourly earnings in the latest reading.

Furthermore, slowing growth and inflation abroad is inducing very easy central bank policy; the ECB and BOJ are locked into more, not less, accommodation for the foreseeable future, and Chinese liquidity remains additive. The U.S. economy is not fully immune from these growth and liquidity dynamics, and the rise in the dollar will have some restraining effect on inflation and on net exports. In addition, money flowing into the U.S. from foreign reserve managers is creating demand for Treasuries that is fairly insensitive to changes in the U.S. domestic economy and contributing to the currency appreciation.

While the U.S. yield curve is poised to flatten as we enter into this tightening cycle, the yield on the ten year is unlikely to move meaningfully beyond the 3% level even as short- term rates rise. Further support for U.S. rates will be provided by a strong U.S. dollar and yield that handily eclipses that of global alternatives like German bunds and Japanese government bonds.

Investment Grade Corporates

Macro backdrop. The positive outlook for the U.S. economy is supportive of both risk appetites and corporate spreads. Fundamentals for corporate issuers remain broadly positive, with some ebb and flow as positive economic conditions are reflected in improved revenue and EBITDA while also inspiring an uptick in shareholder-friendly activity by increasingly confident managements. That said, many investment grade corporate issuers have global footprints and thus are likely to be impacted by widespread economic weakness beyond domestic borders. For instance, the recent decline in commodity prices has not been kind to commodity-sensitive industries, as evidenced by widening spreads in metals and energy of late. Interest rate volatility could also inspire technical pressure for investment grade corporates in the coming months.

Investment outlook. Widening in recent weeks to early-2014 levels, corporate spreads currently are fairly valued. Generally speaking, we prefer market segments that are more U.S.-centric given the aforementioned multinational nature of many investment grade corporate issuers. Banks may be particularly susceptible to international volatility, which tends to transmit more quickly through financial concerns than industrial companies. Shorter-dated corporates may be somewhat insulated from any tumult, however, given their reduced sensitivity to changes in market technicals and a credit cycle that has yet to peak. Technical conditions related to recent heavy new issuance should ease as the market heads into earnings season, but the calendar will still be active. Carry or yield is expected to remain the primary driver of excess returns in this space.

Emerging Markets

Macro backdrop. Growth and inflation across emerging markets is divergent, but we see higher probability of downside surprises given weak demand from the G-3 and weak global trade in general. Though uncertainty around the Fed's tightening path is a cause for concern and weaker commodity prices are a risk, global liquidity conditions are generally supportive of emerging markets. As such, flows are not leaving the asset class but are being circulated within it. For example, tensions between Russia and Ukraine are redirecting flows away from Central Europe and toward Latin America and Asia.

Conclusion

While the recent news from PIMCO does have the ability to influence certain sectors of the market, we fully expect macroeconomics and broader technical factors to be the dominant forces in fixed income. Any change in market dynamics caused by portfolio transitions among fixed income managers not only will be an exception to the rule, but also a potential tactical investment opportunity on which to capitalize.

While the U.S. economic outlook continues to improve, a broad array of challenges are impeding recovery

DESPITE NOISE CONTINUED

elsewhere. These weak global economic conditions combined with the rock-bottom U.S. labor market participation rates, a stronger U.S. dollar and the absence of any domestic wage pressures will allow the Fed to remain "exceptionally patient" as it moves to raise interest rates. As such, changes in U.S. monetary policy will be gradual, and we believe the extent of federal funds rate hikes will most likely undershoot even the central bank's own expectations. Moreover, inflationary pressures outside U.S. borders are benign, and the net level of global monetary accommodation remains positive.

However, while strength in the U.S. is a tailwind for U.S. spread assets, lack of attention to global concerns may leave one exposed to bouts of episodic volatility and the large downside risks that are likely to emerge from beyond our borders, particularly from Europe, where inflation is trending near zero. While technical pressures emanating from the big bond manager in California bear watching, immunizing portfolios against the potential tail risks looming farther east is our prescribed course for navigating the fixed income landscape.

This article is an excerpt from Voya Perspective's Market Insight. Despite Noise, Macro Factors Will Drive Income Markets. October 6, 2014.

COMMUNICATION CORNER: 2015 PLAN LIMITS

This month's employee memo is titled: 2015 Plan Limits. This memo spells out the 2015 contribution limits for retirement plans.

As a reminder, we post each monthly participant memo online via the Fiduciary BriefcaseTM (fiduciarybriefcase.com).

Call or email Brad Knowles if you have questions or need assistance.

To remove yourself from this list, or to add a colleague, please email Aaron Jack at ajack@heritagetrust.com or call (405) 608-8660.

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