Plan Sponsors: *Is Your Retirement House in Order?*

by Ari Jacobs, Steve Wagner and Kim Holland

Given the turmoil retirement plans have experienced over the past three years, stakeholders are asking plan sponsors tough questions. *To ensure that their retirement plan house is in order, plan sponsors can use the overview provided by this article to examine their retirement program's design, cost and operations. Doing so will help plan sponsors identify areas of concern or opportunities for change, assess the risks and costs involved, and develop an action plan so that they are prepared to manage whatever lies ahead this year and in the future.*

During the past three years, retirement plan sponsors have experienced the worst roller-coaster ride ever. After several years of pension plan surpluses, contribution holidays and satisfied investors, plan sponsors are now facing underfunded plans, huge contribution requirements, increasing (and volatile) expense costs and confused employees unsure of where to invest their retirement savings.

In the midst of all this turmoil, internal and external stakeholders are asking tough questions. As a retirement plan sponsor, you should be examining your plans to determine whether your "retirement house" is in order.

Here's a blueprint for addressing the key elements of a retirement program—design, cost and operations—to ensure that you are prepared to manage whatever lies ahead this year and in the future.

DEVELOP RETIREMENT PLAN OBJECTIVES

Especially in difficult economic times, it's important to ask whether your retirement program is serving your organization's goals. Are the objectives of the plan to attract and retain talent? Do employees understand and appreciate it? Is your organization encouraging participation in your savings plan and helping employees achieve financial security? Most importantly, you must be able to accomplish these objectives within identified fiscal constraints. Successful companies document their objectives, regularly measure progress against quantifiable goals and modify or update as appropriate. And knowing your retirement objectives prevents knee-jerk, shortsighted changes that may not be appropriate in the long term.

REVIEW RETIREMENT PROGRAM DESIGN

With escalating plan costs (especially for defined benefit plans) and increased scrutiny by employees due to market losses and diversification issues, it has never been more critical for plan sponsors to focus on the design of their retirement programs. Many plan designs—pension plans, savings plans and retiree health care plans—were put in place in another era and have become "broken" or out of date. Don't be afraid to "fix" your plan design—maximizing the value of your organization's investment in these plans is one of your key obligations as a plan sponsor.

EVALUATE RETIREE WELFARE PLANS

Welfare benefits for retirees, particularly medical benefits, originated and grew in popularity during the 1950s, 1960s and 1970s. At that time there were few retirees, medical costs were under control and onerous accounting rules didn't exist. One of the top priorities for employers today is the reduction or elimination of retiree medical subsidies. And while reducing or eliminating these benefits may not affect current retirees or employees nearing retirement, it is becoming quite common for employers to change the program for future new hires offering "access" to these benefits, but at "employee-pay-all" rates. Companies must monitor their retiree welfare plans with an eye on the government's policy in this area. Taking action this year is especially important as companies face some of their greatest cost-control challenges.

UNDERSTAND YOUR CURRENT AND FUTURE PENSION PLAN COSTS

Now that contribution holidays are over and pension income is becoming pension expense, the importance of advance planning cannot be overstated. New unexpected changes in retirement costs can adversely impact a company's stock price. And if 2003 costs aren't bad enough, costs are likely to rise in the coming years as prior years' asset losses continue to get phased into expense recognition. Fortunately, tools exist to help you budget more easily and recognize the long-term impact of shifting asset results and interest rates. Understanding current and future years' costs not only prevents surprises, it allows you time to plan for higher cost levels or to make necessary plan modifications.

REVISIT ASSET ALLOCATION STRATEGIES

One of your most important decisions is selecting an asset allocation for your defined benefit plan. A sound long-term investment strategy should balance risk tolerance with expected returns and investment time horizon. Given the recent shift in the equity market and the change in capital asset return expectations, it is critical to reassess whether your current allocation policy is appropriate. An asset liability study models cash flow and expenses requirements and will help you determine your company's optimal investment strategy. And remember to review your defined contribution investment choices by analyzing current options and studying new alternatives such as increasingly popular brokerage accounts.

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EXAMINE ACTUARIAL ASSUMPTIONS

In light of current economic and demographic projections, some actuarial assumptions might be outdated. You should reassess these assumptions with your plan actuary and with management and modify assumptions that are no longer the best predictors of future experience. Areas of focus should include:

- Reflecting new retirement patterns due to longer life spans and high retiree medical costs
- Adding short-service termination rates that differ from turnover patterns of longer service employees
- Acknowledging new investment return and inflation outlooks
- Reviewing recent compensation and bonus patterns compared to future expectations.

REVIEW RETIREMENT PLAN COMMITTEE STRUCTURES AND RESPONSIBILITIES

Concern about the role of a fiduciary and potential costs of litigation have caused many plan sponsors to ask how to better position themselves to satisfy fiduciary duties. Given the heightened scrutiny, 2003 is the perfect time to review and improve plan governance policies and practices such as:

- The role, composition and structure of plan committees
- The procedures used to make key decisions matters such as plan investments, service providers and benefit claims
- The allocation, performance and oversight of plan responsibilities.

The goal is to enable you to better manage risks and avoid ERISA claims by establishing proper procedures and a structure for adhering to them.

MANAGE RETIREMENT PLANS GLOBALLY

Too often companies do not focus enough attention on retirement programs outside of their home country. With decision making left to local offices, you may have programs that are using inappropriate assumptions or inaccurate accounting standards. Creating one consolidated reporting system that includes global assumption verification increases the quality of the financial reporting. Additionally, focusing on strategic global design decisions can reduce costs and ensure alignment with your company's business goals. These include developing special programs for internationally mobile employees, looking for opportunities with multinational pools, or creating a global investment strategy focusing on all retirement assets.

REVIEW ADMINISTRATIVE PRACTICES AND PROCEDURES

If the administration of your plans is faulty, much may be at stake. Your plans must be legally up to date. The administration of your plans must follow plan language. The calculation process must work properly in order to minimize the risk of errors and over/underpayments. Compliance issues may be uncovered in the areas of spousal consent, required minimum distributions, legally required notices, plan loans, documented and consistent processes for claims and appeals, or qualified domestic relations orders. In the area of administration, small mistakes can have huge consequences—the effort involved in "fixing" an error may be as onerous as the actual economic impact of the error itself. Don't wait for an IRS or DOL audit to uncover your problems.

EVALUATE DELIVERY SYSTEMS

Many plan sponsors are still calculating benefits manually or using outdated (and unchecked) administrative systems, which are inadequate when it comes to processing numerous calculations or getting a retirement or survivor into pay status. This is especially problematic given the softness of the economy, the nervousness of plan participants and the significant number of terminations and retirements. And a broken delivery system or bad data can restrict your ability to implement important plan changes. Evaluate your current systems and processes and investigate new systems or services that might better serve your needs and enhance your participants' experience with the plans. Our research has shown that the value employees place on their plans is greatly influenced by the way those plans are delivered and communicated.

BOOST THE PERCEIVED VALUE OF YOUR PLANS

With the recent stock market downturn and volatility, it's more important than ever to communicate to your participants and provide them with information to understand their current benefits and tools to help them plan for their long-term financial security. When employees appreciate their plan, plan sponsors realize greater value for the dollars spent. Communication campaigns and self-service tools are a way to raise visibility and create awareness of the plans. And, these days, technology is making it easier to integrate and consolidate all benefits information (pension, savings plan, Social Security, personal investments) and provide real-time estimates and projections for retirement planning.

Retirement plan sponsors are facing some of their greatest challenges of this generation. By examining your retirement program design, cost and operations, you can identify your areas of concern or opportunities for change, size up the risks and costs involved, and develop your action plan to ensure that your retirement plan house is in order. ◀