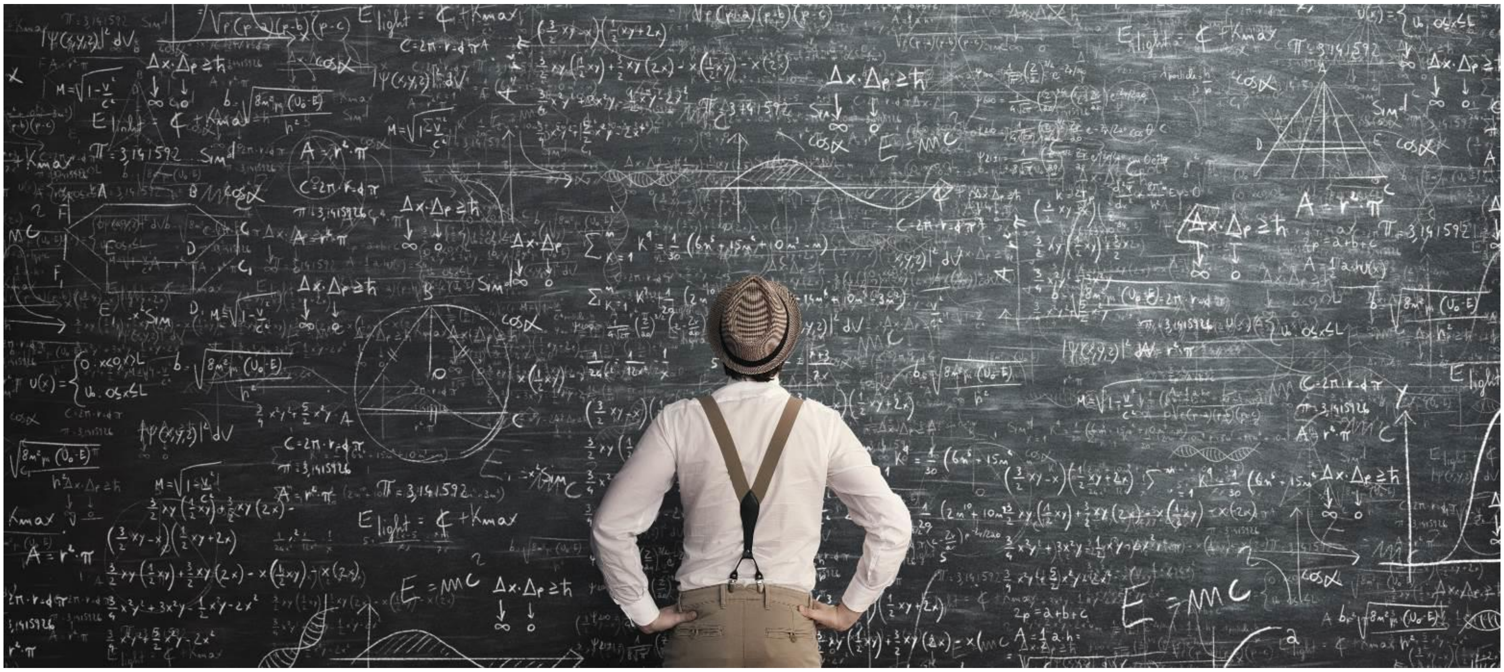
PREMIER RETIREMENT PLAN ADVISORS

Retirement Times

October 2018



How Do You Monitor a Dash? Evaluating Cash Equivalent Funds

Ryan Hamilton, Investment Analyst

As you read your plan's lineup, you see the following scores:

Large Cap Fund	9	Great!
Small Cap Fund	8	Good!
International Fund	10	Perfect!
Fixed Income Fund	10	Perfect!
Stable Value	--	Hmm…what does that mean??

Periodically you review your plan's fund lineup; you place some funds on Watchlist, you replace under-performers and you continue to monitor those funds that score acceptably. But, you see a dash next to your cash fund and wonder, what should you do? Traditional evaluation metrics can be difficult to apply to cash funds. You can look at returns, but without an appropriate benchmark or a way to directly measure the risk taken by the fund, the market value performance number can be difficult to interpret. Perhaps fees can provide the answer, but there are wrap fees, investment management fees and trustee fees, all assuming there is a stated fee to review in the first place. What is a fiduciary to do?

While cash fund due diligence can be intimidating, there are key differentiators among stable value funds that fiduciaries can review to document that a fund is a good fit for their participants. Ultimately stable value funds are not too different from other funds within a plan lineup and the strategies to evaluate them are similar. There exists an established methodology incorporated into your IPS for evaluating these standard funds. Let's evaluate how well that framework can be applied to the stable value universe.

The first component for evaluation of the RPAG Scorecard is a fund's style. Does the fund stick to its professed asset class? Do the same for a stable value fund's portfolio. Is it allocating to assets and securities that are appropriate for a high-quality, short-term fixed income fund? Also evaluate the fund's diversity of allocation. Monitoring its allocating across a variety of subsectors of fixed income (treasuries, corporate bonds, mortgage backed securities, etc.).

The next criteria is evaluation of risk and return. There are a plethora of data points for evaluating stable value fund risk and return. With regard to return, examine a fund's crediting rate or its yield relative to the stable value universe to evaluate this fund's performance. Similar to traditional funds, performance needs to be examined relative to the risk taken. For evaluating risk the underlying portfolio is important. Review the credit ratings of the underlying securities, verify the average duration or maturity relative to the funds' peers, and evaluate the asset managers investing the underlying portfolio. Also review the number of wrap providers for the portfolio and their credit rating.

The final quantitative component of the RPAG Scorecard is peer group review. Once again a stable value fund's evaluation can follow this same methodology. Evaluation of a fund's market-to-book ratio, relative to its peers, is a key component of portfolio health and to identify potential issues early. Cash flows in and out of a fund relative to the universe give valuable insight to how quickly the portfolio can react to changing market conditions.

For qualitative components, look at the same key characteristics that are evaluated for standard funds, as well as a few unique characteristics to stable value. A long tenured and constant management team is important no matter the type of fund. Also, while there are additional fees in the stable value universe, evaluating them relative to the universe is still important. Unique to stable value is a fund's exit provisions (is there a put, and if so how long) and the fund's high yield policy to ensure both align with participant best interests.

Stable value funds seem unique, and they do have peculiar challenges when evaluating them, it's still a crucial task for fiduciaries. The same process that has been established within the plan's IPS to evaluate the core line-up, can be adapted to evaluate stable value funds in a similar manner.

All the data points identified as key components of evaluation can be found on the RPAG stable value fund factsheets.

Stable Value Fund Terminology Cheat Sheet

Term	Definition
Stable Value Funds	A cash alternative investment option within tax-qualified retirement plans. Typically invests in high-quality, short-term fixed income securities.
Wrap	An insurance contract purchased by the Stable Value fund that ensures participants are paid out at book value when they withdraw money.
Book Value	The value of the original investment increased by the stated crediting rate.
Crediting Rate	The set rate of the return the participants in the fund receives. The rate is reset at varying intervals depending on the fund.
Market Value	The value of the underlying portfolio of securities. Will often fluctuate around the book value.
Market Value Adjustment (MVA)	A liquidity restriction upon Stable Value funds that adjusts book value to market value upon an employer initiated event.
Credit Quality	The credit rating of the underlying securities within the portfolio

About the Author, Ryan Hamilton
Ryan works closely with advisors and plan sponsors on investment due diligence and in-depth analysis of manager performance and platform and provider benchmarking. Prior to joining RPAG, Ryan worked for a third-party administrator as an associate administrator managing annual compliance for defined contribution and defined benefit plans. He earned a Bachelor of Arts degree from UCLA and is a CFA Level III Candidate.

Beware of the IRS and DOL: Four Red Flags They Seek on Form 5500

The Form 5500 is an ERISA requirement for retirement plans to report and disclose operating procedures. Advisors use this to confirm that plans are managed according to ERISA standards. The form also allows individuals access to information, protecting the rights and benefits of the plan participants and beneficiaries covered under the plan.

Make sure you are compliant. Be aware of red flags that the IRS and DOL look for on Form 5500 filings:

1. **Not making participant deferral remittances "as soon as administratively possible" is considered a fiduciary breach** and can make the plan subject to penalties and potentially disqualification. Delinquent remittances are considered to be loans of plan assets to the sponsoring company.

2. **An ERISA fidelity bond (not to be confused with fiduciary insurance) is a requirement.** This bond protects participant assets from being mishandled, and every person who may handle plan assets or deferrals must be covered.

3. **Loans in default** for participants not continuing loan repayments, or loans that are 90 days in arrears, **are a fiduciary breach** that can make the plan subject to penalties and disqualification.

4. **Corrective distributions,** return of excess deferrals and excess contributions, along with any gains attributed **must be distributed in a timely manner** (typically two and a half months after the plan year ends). In some cases these fiduciary breaches can be self-corrected if done within the same plan year in which they occurred, and may be considered additional breaches if they extend beyond the current plan year.

This is a partial, non-exhaustive list of common Form 5500 red flags. If you're concerned about ERISA compliance, contact your advisor sooner, rather than later.

For more background on the Form 5500, visit the Society for Human Resource Management online. See "Regulatory 5500: What is Form 5500, and where are instructions for completing it?"

Hey Joel! – *Answers from a recovering former practicing ERISA attorney*

Welcome to *Hey Joel*! This forum answers plan sponsor questions from all over the country by our in-house former practicing ERISA attorney.

Hey Joel,

My prospect is a 501(c)(3) organization that is not affiliated with a church or school. Are they eligible for a 401(k) plan? Are there any benefits over a 403(b) plan?

- *Contemplating in Kansas*

Dear Contemplating,

Contemplate no more! A 501(c)(3) organization is a nonprofit organization and can sponsor either a 401(k) plan or a 403(b) plan. In 1996, the law changed allowing nonprofit organizations to choose either the 401(k) or 403(b) plan for their employees. Here are some key differences between the two types of plans:

- Unlike 401(k) plans, 403(b) plans are not subject to nondiscrimination testing requirements for salary deferral contributions. The nondiscrimination testing rules that apply to 401(k) plans sometimes require that salary deferral contributions be returned to highly compensated employees due to the results of nondiscrimination testing. This does not happen with 403(b) plans.
- Annual limits are the same for both a 401(k) plan and 403(b) plan, except that the 403(b) plan may elect an additional form of catch-up contribution for participants who have 15 years of service, giving participants more flexibility.
- 403(b) plans must follow the “universal availability” rule for eligibility to defer salary, meaning that if an employer permits one employee to defer salary into a 403(b) plan, they must extend the offer to all employees.
- Some nonprofit organizations have established 401(k) plans in recent years, as the 401(k) is more well-known to their employees.

Hopefully that sheds some light on the differences between a 401(k) plan and a 403(b) plan.

The ERISA Wizard,

Joel Shapiro

About Joel Shapiro, JD, LLM

As a former practicing ERISA attorney Joel works to ensure that plan sponsors stay fully informed on all legislative and regulatory matters. Joel earned his Bachelor of Arts from Tufts University and his Juris Doctor from Washington College of Law at the American University.

If you have a question for Joel, please send it to your plan advisor. It may be featured in a future issue!

Participant Corner: Skip the Line, But Don't Skip the Match

This month's employee flyer encourages participants to meet their employer match and not leave money on the table. Hang the memo in your lunchroom or distribute to employees along with their paychecks. Download the flyer from your Fiduciary Briefcase at fiduciarybriefcase.com. Please see an excerpt below.

This material was created to provide accurate and reliable information on the subjects covered but should not be regarded as a complete analysis of these subjects. It is not intended to provide specific legal, tax or other professional advice. The services of an appropriate professional should be sought regarding your individual situation.

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