Retirement Plan Newsletter

Quarterly Newsletter I Quarter Ending June 30, 2021

Benefit Financial Services Group I 2040 Main Street, Suite 720, Irvine CA 92614 I Phone: 949.955.2552 I www.bfsg.com

Inside This Article

Markets in Review

U.S. stocks continued to rally during the second quarter with the S&P 500 Index[1] returning 8.55% and ending the quarter at an all-time high. The equity markets benefited from strong economic growth, low interest rates, increasing company profits and substantial progress on the vaccine front in the developed markets.

In a reversal of the trend last quarter, the equity markets rotated back to favoring growth over value stocks. The Russell 1000 Growth Index returned 11.9%, while the Russell 1000 Value Index returned 5.2% during the quarter.[2]

Another trend reversal occurred with large caps outperforming small caps during the quarter. However, small cap stocks performed so well during the first quarter that they are still outperforming large caps on a year-to-date basis.

All S&P 500 sectors were in positive territory during the quarter with the exception of utilities, with real estate and technology leading the way returning 13.1% and 11.6%, respectively.

Non U.S. equity markets also posted positive returns during the quarter with developed markets (as measured by the MSCI All Country World Index ex US) leading emerging markets (as measured by the MSCI Emerging Markets Index).[3] Conditions in Europe continued to improve as many pandemic-related restrictions were lifted.

The U.S. Treasury yield curve flattened slightly during the quarter as longer-term rates continued to fall. All major fixed income sectors experienced positive returns during the quarter as bond yields fell by over 25 bps. The 10-year Treasury fell from 1.74% to 1.45% during the quarter, resulting in a positive return of the Barclays US Aggregate Bond Index of 1.83%.[4]

U.S. economic growth in the second quarter of 2021 was supported by accommodative fiscal and monetary policies, pent-up consumer demand leading to strong corporate earnings, and a rollback of many of the pandemic-related restrictions. Second quarter GDP expanded at an annual rate of approximately 6.5% based on the first advanced estimate.[5]

The economy added 1.7 million jobs during the quarter, however, despite the latest employment growth, the economy is still approximately 7 million jobs short of pre-COVID levels. Notable job gains occurred in leisure and hospitality, public and private education, professional and business services, and retail trade. The unemployment rate continued to fall and equaled 5.9% in June. Reported job openings have been rising and are approximately equal to the number of unemployed.[6]

Inflation received much attention during the second quarter as headline inflation, measured by the Consumer Price Index (CPI-U), more than doubled to 5.4%, up from 2.6% the previous quarter, the biggest spike in inflation in more than a decade. Many businesses cited increased prices from supply chain disruptions, higher raw materials costs, and shipping constraints. Areas of the economy experiencing pent-up demand saw double digit price increases, such as transportation, energy prices and used vehicles, which were major contributions to the significant jump in inflation figures for the quarter.[6]

***

Missing Participants: Ready or Not, Here I Come!

Most plan sponsors can relate to the trials and tribulations of having missing participants in their retirement plan. At times, it may feel like you are on the losing end of an intense game of hide-and-seek. Your opponents, the missing participants, may not have intended to pick the best hiding spots, but in many cases, they have surely succeeded. Now you are tasked with tracking them down and upping your game to avoid this scenario in the future.

So, what are missing participants, exactly? Missing participants are former employees who left an account balance in a retirement plan and did not keep their contact information up to date. In addition, they may no longer actively manage their accounts. There are a few factors that have led to an increase in the number of missing participants in retirement plans over the years. Unlike the generations of our parents and/or grandparents, employees do not typically work their entire career with one firm anymore. Another contributing factor is the mobilization of the workforce. The ability to work remotely has mobilized employees even more these days. Some have chosen to relocate across the country while others find themselves living in a new locale every few months. Many of us can relate to this, especially over the past 18 months. With these two factors alone, it can be difficult to keep track of plan participants once they leave your firm.

It is important to develop procedures to ensure contact information is up to date and to illustrate the proactive measures employed in this effort. Whatever steps you implement, you should relay to employees and participants why keeping these details current is important and how it can affect them. Ask any employee if they would be okay with losing track of their retirement account - the answer would probably be a resounding no. A few ideas based on the Department of Labor's (DOL's) Best Practices are included below.

- **Annual Review:** Have plan participants verify their contact information on file at least annually. This includes addresses, phone numbers, and email addresses. You can also include a review of beneficiaries at this time. Keep in mind this does not only include current employees but terminated or retired participants as well. Also consider making the review part of your company's exit interview.

- **Mailings:** When completing a mailing, provide a form where recipients can update their contact information.

- **Returned Mail:** Initiate searches for participants as soon as mail has been returned as undeliverable. This includes mail marked as "return to sender," "wrong address," "addressee unknown," or otherwise.

- **System Log In:** If participants regularly log into a system, set a reminder or pop-up directing users to verify their contact information.

Unfortunately, even with the best of plans in place, plan sponsors may still have participants who go missing. So, not only do you need to incorporate procedures for ensuring contact information is up-to-date, but you also need to document procedures for locating participants once they go missing. The DOL provides a list of search methods that should be used to locate missing participants. Some of these methods are included below.

- Send a notice using certified mail through USPS or a private delivery service with similar tracking features.

- Check the records of the employer or any related plans of the employer.

- Send an inquiry to the designated beneficiary or emergency contact of the missing participant.

- Use free electronic search tools or public record databases.

At some point, most plan sponsors will find themselves with participants who have gone missing. It's important to remember plan sponsors have a fiduciary responsibility to follow the terms of the plan document and ensure participants are paid out timely. Having a well-documented, organized process which addresses missing participants, along with proof the process is followed, will prove worthwhile.

More information regarding the Department of Labor's Best Practices can be located on their website.

https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/retirement/missing-participants-guidance/best-practices-for-pension-plans

***

Safe Harbor: A Cure For Your Testing Headaches

A crucial requirement for 401(k) plans is that the plan must be designed so it does not unfairly favor highly compensated employees (HCEs) or key employees (such as owners) over non-highly compensated employees (NHCEs). To satisfy this requirement, the IRS requires that plans pass certain nondiscrimination tests each plan year. These tests analyze the rate at which HCE and key employees benefit from the plan in comparison to NHCEs. Failed tests can result in costly corrections, such as refunds to HCEs and key employees or additional company contributions. Luckily for plan sponsors, there is a plan design option – a safe harbor feature, that allows companies to avoid most of these nondiscrimination tests.

To be considered safe harbor and take advantage of the benefits afforded to safe harbor plans, there are several requirements that must be satisfied. Below we will take a look at the key characteristics of a safe harbor plan.

The plan must include one of the following types of contributions. The chosen formula is written in the plan document, and with the exception of HCEs, must be provided to all eligible employees each plan year. Please note that additional options, not covered here, are provided for plans that include certain automatic enrollment features.

- **Safe Harbor Match:** With this option, the company makes a matching contribution only to those employees who choose to make salary deferral contributions. There are two types of safe harbor matching contributions:
    - **Basic Safe Harbor Match:** The company matches 100% of the first 3% of each employee's contribution, plus 50% of the next 2%.
    - **Enhanced Safe Harbor Match:** Must be at least as favorable as the basic match. A common formula is a 100% match on the first 4% of deferred compensation.
- **Safe Harbor Nonelective:** With this option, the company contributes at least 3% of pay for all eligible employees, regardless of whether the employee chooses to contribute to the plan.

Unlike company profit sharing or discretionary match contributions, safe harbor contributions must be 100% vested immediately. In addition, the contribution must be provided to all eligible employees, even those who did not work a minimum number of hours during the plan year or who are not employed on the last day of the plan year.

In most cases, an annual safe harbor notice must be distributed to plan participants within a reasonable period before the start of each plan year. This is generally considered to be at least 30 days (and no more than 90 days) before the beginning of each plan year. For new participants, the notice should be provided no more than 90 days before the employee becomes eligible and no later than the employee's date of eligibility. The safe harbor notice informs eligible employees of certain plan features, including the type of safe harbor contribution provided under the plan.

If all safe harbor requirements have been satisfied for a plan year, the following nondiscrimination tests can be avoided:

- **Actual Deferral Percentage (ADP):** The ADP test compares the elective deferrals (both pre-tax and Roth deferrals, but not catch-up contributions) of the HCEs and NHCEs. A failed ADP must be corrected by refunding HCE contributions and/or making additional company contributions to NHCEs.
- **Actual Contribution Percentage (ACP):** The ACP test compares the matching and after-tax contributions of the HCEs and NHCEs. A failed ACP must be corrected by refunding HCE contributions and/or making additional company contributions to NHCEs.
- **Top Heavy Test:** The top heavy test compares the total account balances of key employees and non-key employees. If the total key employee balance exceeds 60% of total plan assets, an additional company contribution of at least 3% of pay may be required for all non-key employees. It is important to note that a plan will lose its top heavy exemption if company contributions, in addition to the safe harbor contribution, are made for a plan year (e.g., profit sharing or discretionary matching contributions).

So, how do you know if a safe harbor plan is a good fit for your company? As discussed above, the primary benefit of a safe harbor plan is automatic passage of certain annual nondiscrimination tests. If your plan typically fails these tests, resulting in refunds or reduced contributions to HCEs and key employees, your company may benefit from a safe harbor feature. Predictable annual contributions also provide a great incentive for employees to save for their retirement. However, if you do not currently offer an annual match or profit sharing contribution to your employees, a safe harbor formula may significantly impact your company's budget. Except for a few limited exceptions, safe harbor contributions cannot be removed during the plan year, so it's important that a company is able to fund these required contributions. As with all things qualified plan related, the key is working with an experienced service provider who can design a plan to suit your company's needs!

***

Upcoming Compliance Deadlines

September 2021

15th: Required contribution to Money Purchase Pension Plans, Target Benefit Pension Plans, and Defined Benefit Plans.

15th: Contribution deadline for deducting 2020 employer contributions for those sponsors who filed a tax extension for Partnership or S-Corporation returns for the March 15, 2021 deadline.

30th: Deadline for certification of the Annual Funding Target Attainment Percentage (AFTAP) for Defined Benefit Plans for the 2021 plan year.

October 2021

15th: Extended due date for the filing of Form 5500 and Form 8955.

15th: Due date for 2021 PBGC Comprehensive Premium Filing for Defined Benefit Plans.

15th: Contribution deadline for deducting 2020 employer contributions for those sponsors who filed a tax extension for C-Corporation or Sole-Proprietor returns for the April 15, 2021 deadline.

Sources:

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The Russell 1000 Index is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index, which consists of approximately 92% of the total market capitalization of all listed stocks in the U.S. equity market. The Russell 1000 Growth index is composed of large- and mid-capitalization U.S. companies whose earnings are expected to grow at an aboveaverage rate relative to the market.The Russell 1000 Value index is composed of large- and mid-capalization U.S. companies that are thought to be undervalued by the market relative to comparable companies.
3. The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 27 Emerging Markets (EM) countries*. With 2,354 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.
4. The Barclays Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market.
5. Source: US Bureau of Economc Analysis (https://www.bea.gov/data/gdp/gross-domestic-product)
6. Source: U.S. Bureau of Labor Statistics (https://www.bls.gov/)