Retirement Plans: The Small Business Dilemma

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Overview

Although there has been an increase in the number of small U.S. businesses — those with two to 99 employees — that offer 401(k) plans since 2008 small businesses remain less likely than others to offer a retirement plan; most U.S. employees work for a small business.¹ According to the U.S. Census Bureau, 98 percent of businesses in the U.S. have fewer than 100 employees, accounting for approximately 35 percent of the U.S. workforce (40 million workers).

Retirement plans are less prevalent among small employers than are group insurance benefits,² with only 28 percent offering retirement benefits to employees. Companies with two to nine employees are far less likely than small businesses with ten or more employees to offer any insurance or retirement benefits. The majority of American workers, then, lack the ability to save for retirement through an employer-sponsored plan, which puts them at risk for inadequate financial resources in retirement.

Perhaps in recognition of this risk and the market potential, several companies long known for their retirement plans sales in the large plan market (those with higher assets and more participants) are now focusing on the smaller plan market including small businesses, and other companies are attempting to capture this market.

- In March 2012, Bank of America launched Merrill Edge® Small Business 401(k).
- In April 2013, Vanguard announced that its Vanguard Retirement Plan Access™ was available to third-party administrators who are used more often in the smaller plan market.
- In July 2013, ShareBuilder 401(k) offered a new plan option with no up-front fees for small and medium-sized businesses after finding that retirement plan set-up costs are a barrier to plan establishment.

¹ShareBuilder 401k
²LIMRA 2012 Small Business Study, Phase 1
METHODOLOGY  From February through March 2012, LIMRA conducted a telephone survey of U.S. small businesses to determine the proportion of firms carrying various types of business insurance, employee benefits, and retirement and savings plans. The survey included 754 private small businesses with 1–99 employees, including the owner, that had been in business for at least one year. Respondents were the individuals that made or shared in the firms’ decisions concerning business insurance and/or employee benefits. The sample was weighted by company size, industry, and region to be representative of the total population of U.S. small businesses, based on data from the U.S. Census Bureau.

In January 2013, LIMRA conducted an online survey of U.S. small businesses to explore a variety of topics pertaining to employee benefits. The survey included 1,184 private small businesses with two to 99 employees, including the owner, that had been in business for at least one year. Respondents were the individuals that made or shared in the firms’ decisions concerning employee benefits. The sample was weighted by company size and industry to be representative of the total population of U.S. small businesses, based on data from the U.S. Census Bureau.

The data presented in this report are from the second phase of the two-phased research on small businesses.
Recommendations

General

- Use this report as background for information about small U.S. businesses and their propensity to offer retirement plans in light of their daily issues and challenges.

Specific

- **Be aware that small business employers may have misconceptions about employee acceptance of automatic enrollment or deferral.** These owners may be more paternalistic than larger employers and may be open to automatic enrollment if they understand that opt-out rates are low and employee acceptance is favorable.

- **Take into account the challenges and issues faced by employers.** Employers more concerned with productivity and retaining employees may be more receptive to offering retirement plans to their employees.

- **Include fiduciary responsibility in discussions with employers.** Many are not aware of their fiduciary responsibility and, consequently, may not be aware of the protections offered since passage of the Pension Protection Act of 2006.

- **Know that the small businesses with higher numbers of employees work with advisors.** Advisors are most often the plan design and investment option resource for small businesses and their awareness of regulatory and other issues, including fiduciary responsibility, is vital.
Retirement Plan Availability

LIMRA research indicates that small businesses most often offer 401(k) plans, followed by a SIMPLE IRAs (Savings Incentive Match Plan for Employees Individual Retirement Account), SEP-IRAs (Simplified Employee Pension Individual Retirement Arrangement) and profit sharing plans as their defined contribution options.

Employers offering a 401(k) plan tend to be established in terms of securing a market for their products, have annual revenues from $500,000 to $5 million, and have been in business fewer than 40 years (Figures 2 and 3). But plan offerings also vary by the type of services a company provides. For instance, companies that provide technical services are more likely to offer a SEP-IRA than a 401(k), SIMPLE IRA, or profit-sharing plan while companies providing health services are more likely to offer a SIMPLE IRA than a 401(k) plan.
Use of Advisors or Consultants

More than two thirds of the small businesses offering a 401(k) plan use an advisor or consultant for assistance with retirement needs; and, that advisor or consultant is most often a financial advisor or broker, followed by a third-party administrator (TPA).

Advisors may offer many different types of assistance for retirement plans but sponsors may choose just a few of those options. For instance, most of the plan sponsors use their advisor for investment options and plan design, while a minority gets help with evaluating a new provider, participant advice, and other services (Figure 5).
There is a direct correlation between revenues and the likelihood to use an advisor or consultant to assist with retirement needs. The smallest plans likely do not have the financial resources for an advisor, but LIMRA data show that companies with annual revenues of $5 million or more and with 16 to 20 employees are the most likely to use such an advisor (Figures 6 and 7).

**Figure 6** — Likelihood to use an Advisor or Broker
*By 2012 Annual Gross Revenue*

<table>
<thead>
<tr>
<th>2012 annual gross revenue</th>
<th>Likelihood to use an Advisor or Broker</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1&lt;100,000</td>
<td>54%</td>
</tr>
<tr>
<td>$100,000-$500,000</td>
<td>60%</td>
</tr>
<tr>
<td>$500,000-$1 million</td>
<td>66%</td>
</tr>
<tr>
<td>$1 million-$5 million</td>
<td>70%</td>
</tr>
<tr>
<td>$5 million-$10 million</td>
<td>83%</td>
</tr>
<tr>
<td>$10 million-$20 million</td>
<td>84%</td>
</tr>
<tr>
<td>$20 million+</td>
<td>87%</td>
</tr>
</tbody>
</table>

**Figure 7** — Likelihood to use an Advisor or Broker
*By number of full-time employees*

<table>
<thead>
<tr>
<th>Number of full-time employees</th>
<th>Likelihood to use an Advisor or Broker</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-5</td>
<td>62%</td>
</tr>
<tr>
<td>6-9</td>
<td>74%</td>
</tr>
<tr>
<td>10-15</td>
<td>65%</td>
</tr>
<tr>
<td>16-20</td>
<td>96%</td>
</tr>
<tr>
<td>20+</td>
<td>75%</td>
</tr>
</tbody>
</table>
Fiduciary Responsibility

We asked small businesses about their understanding of two of the sections of ERISA that describe fiduciary responsibilities: Section 3(21) describes the standards for determining whether an individual can be considered a fiduciary and Section 3(38) describes an investment manager fiduciary who has control of and authority over the plan’s assets. This type of fiduciary can only be a bank, insurance company, or registered investment advisor (RIA).

Retirement plan providers can offer plan sponsors a Section 3(21) service, a Section 3(38) service, or both. Under a Section 3(21) service a third party issues a certification stating that the methods used by the provider to select, monitor, and replace investments in the plan meet a required standard; or, the plan sponsor may have access to a pre-screened investment line-up that corresponds to the plan’s participant demographics. When retirement plan providers offer plan sponsors Section 3(38) services, they assume legal responsibility and liability for investment decisions in the plan, which helps plan sponsors to better manage and mitigate their fiduciary risk.

Respondents had access to these definitions when asked about their responsibilities.

Half of employers understand their fiduciary responsibility

Slightly more than half of the employers understand their fiduciary responsibility, but one quarter of the employers are in the middle of the two extremes of not understanding at all and understanding extremely well and nearly one quarter of employers do not understand their fiduciary responsibility (Figure8).

![Figure 8 — Employer Understanding of Fiduciary Responsibility](image-url)
Despite their lack of understanding and the potential for penalties, about one third of the employers not already delegating their fiduciary responsibility to another entity are interested in doing so (Figure 9) and that interest is stronger for Section 3(21) services than for Section 3(38) services. For Section 3(21) services, that interest is strongest among businesses with the fewest number of employees (two to five) and highest (20 or more). Interest in Section 3(38) services is more broadly spread among plan sizes (Figures 10 and 11).
Interest in delegating fiduciary responsibility varies by the size of the business. The smallest and largest employers are more likely to want to delegate fiduciary responsibility than are employers with 10 to 20 employees.

Because of the substantial penalties that can result from a breach of fiduciary responsibility, it is imperative that employers understand their liability and are aware of means to eliminate or minimize those penalties; and, if covered under Section 3(21) or 3(38), understand what fiduciary services their advisors provide.

If small businesses do not understand their fiduciary responsibility they may not be aware that they can reduce this responsibility by designing their retirement plans in accordance with the Pension Protection Act of 2006 through safe-harbor provisions such as those for employer matches and enrollment. Plan providers and advisors can alleviate some of the fiduciary concerns as a lead-in to retirement plan discussions.
Employer Issues and Challenges

Employers offering retirement or insurance benefits

Small businesses that offer retirement or insurance benefits are most concerned with the cost of health care and other insurances, ranking them the most critical overall, and are less concerned with retaining employees or increasing productivity. Economic uncertainty rounds out the top-three issues or concerns (Figure 13).

Regardless of revenue, all companies are equally concerned with the cost of insurance, health care, and taxes, as well as regulatory compliance. But, for other issues the level of concern depends on the size of the company and its industry. For instance, firms with revenue of $20 million or more are least concerned with economic uncertainty, but companies in the $5 million to less than $10 million range are most concerned with economic uncertainty — especially compared with companies earning $10 million to less than $20 million in revenue. On the other hand, companies with annual revenue of $20 million or more are more concerned than the others with recruiting and retaining employees (Figure 14).
Employers not offering retirement or insurance benefits

Most of the employees who work for small U.S. businesses do not have access to employer-sponsored retirement or insurance benefits, and, except for the cost of benefits, these employers have the same issues and challenges. However, more than one quarter of these companies also have concerns with health care costs, perhaps on a personal level rather than as a company concern (Figure 15).
As we saw for companies that offer benefits, the relative importance of each issue varies with employer characteristics. Most deem economic uncertainty and taxes as the most critical issues, but companies in business for more than a century identify regulatory issues as the greatest issue or challenge, at a level that is significantly higher than most other businesses (Table 1). Small businesses more concerned with financial issues may be less likely to consider another expense — a retirement plan — a pressing need. Companies with fewer than ten employees, however, find increasing productivity and retaining employees more of a challenge than companies with 20 to 29 employees. Offering retirement benefits may be one way to alleviate that concern.

<table>
<thead>
<tr>
<th>Number of Years in Business</th>
<th>Issue or Challenge</th>
<th>Percent Rating Issue or Challenge Critical</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-9</td>
<td>Taxes</td>
<td>42%</td>
</tr>
<tr>
<td>10-19</td>
<td>Economic uncertainty</td>
<td>48%</td>
</tr>
<tr>
<td>20-29</td>
<td>Economic uncertainty</td>
<td>47%</td>
</tr>
<tr>
<td>30-39</td>
<td>Economic uncertainty</td>
<td>40%</td>
</tr>
<tr>
<td>40-49</td>
<td>Economic uncertainty, Taxes</td>
<td>66%</td>
</tr>
<tr>
<td>50-74</td>
<td>Lack of available capital</td>
<td>41%</td>
</tr>
<tr>
<td>75-99</td>
<td>Economic uncertainty, Taxes, Lack of available capital</td>
<td>24%</td>
</tr>
<tr>
<td>100+</td>
<td>Complying with regulations</td>
<td>75%</td>
</tr>
</tbody>
</table>

Small businesses are concerned on a daily basis with myriad issues and may not have the inclination to be concerned with offering their employees retirement plans. Many small businesses do offer retirement or insurance benefits to their workers, but more do not; and, much of the retirement industry focus is on educating employees or defined contribution plan participants. There is also a need to educate employers about the types of plans they can offer, the costs and benefits of offering retirement plans, and which plans are the most important for their specific employees and industry. For instance, a recent study from J.P. Morgan Asset Management indicates that plan sponsors are concerned that their participants may be upset if employers implement automatic enrollment and automatic deferral escalation. However, automatic enrollment opt-out rates remain low, which implies that employees are in favor of this practice or at least do not object to it. J.P. Morgan’s study also found that half of plan sponsors are unaware that use of a qualified default investment alternative may reduce their fiduciary responsibility.

LIMRA’s findings confirm the need for plan sponsor education, but the question remains: Who is responsible for their education? Plan providers may be less likely to educate sponsors than they are participants, and advisors likely need to be trained, as well, if they are going to pass their knowledge to small business owners or officers.
