May 14, 2014

THE IMPACT OF THE UPCOMING RE-PROPOSED DEPARTMENT OF LABOR FIDUCIARY REGULATION ON SMALL BUSINESS RETIREMENT PLAN COVERAGE AND BENEFITS

Greenwald & Associates

Co-Sponsored by the United States Hispanic Chamber of Commerce

Davis & Harman LLP commissioned and co-sponsored this report on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans.

Embargoed until May 14, 2014

Foreword

Javier Palomarez
President & CEO, USHCC

The sustainability of American small business is inherently tied to the prosperity of our nation's workers and their ability to plan for tomorrow. Because small business owners create nearly two-thirds of net new jobs in the U.S., it is imperative to keep their interests top of mind.

As you might imagine, Hispanic entrepreneurs are an increasingly vital segment of the small business demographic. This thriving community numbers more than 3.1 million Hispanic-owned businesses, which will together contribute in excess of $468 billion to the American economy this year.

The United States Hispanic Chamber of Commerce (USHCC), the country's largest Hispanic business organization, advocates on behalf of these enterprises through our network of more than 200 chambers and business associations, as well as over 220 major corporate partners nationwide.

At the USHCC, while we are proud to advocate on behalf of business owners who happen to be of Hispanic descent, we never forget that we are first and foremost American businesses. Every tax bill we pay, every job we create, every product we manufacture, and every service we provide goes to benefit our nation's economy.

Our association, as well as many financial services organizations and business owners, has strong concerns over the possible effects of the U.S. Department of Labor's (DOL) expected regulatory expansion of fiduciary status. This is why the USHCC has proudly partnered with Greenwald & Associates, one of the nation's leading full-service market research firms, to launch this survey. By polling over 600 retirement plan decision-makers at firms classified as small businesses, this study examines the rule's prohibitive nature on investment education and information that can be provided about retirement-plan accounts.

The findings presented here show that far-reaching regulatory changes, like a DOL expansion of fiduciary status, will only impede the ability of small firms to offer their employees retirement-plan accounts, thus hindering American workers from saving for a reliable future.

This report serves as a reputable source of information for policy makers, business leaders, and researchers who seek a thorough examination of DOL's expected regulatory expansion and how small business owners and their employees will be negatively impacted.

EXECUTIVE SUMMARY

Overview

The purpose of this research is to better understand the impact that a re-proposed Department of Labor regulation on the fiduciary status of persons providing investment assistance could have on small business qualified plans, particularly the impact on employees. The re-proposed regulation is generally expected to prohibit retirement plan providers and the advisors who sell retirement plans from assisting employers in the selection and monitoring of funds in the retirement plan. Instead, employers could either perform the functions themselves or hire an independent expert to do it. Please see Appendix 1 for a fuller description of the contemplated content of the re-proposed regulation, as provided to survey respondents.

The findings, as summarized in more detail in the "Summary of Findings" section of this report, were striking.

- **Almost 30% of small businesses with a plan indicate that it is at least somewhat likely that they would drop their plan if this regulation were to go into effect.**
- **Almost 50% of small businesses with a plan say that it is at least somewhat likely that the regulation would result in them reducing their matching contribution, offering fewer investment options, and increasing fees charged to participants.**
- **Close to 50% of small businesses without a plan state that the regulation would reduce the likelihood of them offering a plan, with 36% saying it would reduce the likelihood greatly.**
- **Over 40% of small businesses without a plan say that the regulation would be at least somewhat likely to cause them to charge higher fees to participants and not offer matching contributions.**
- **Over 80% rate the job that their current advisor or record-keeper does as very good or excellent when it comes to investment selection and over 90% are at least somewhat satisfied with the plan's investment options.**

Scope of Study

This study examines three broad topic areas:

- The current environment when it comes to investment selection and monitoring – how it is done today in smaller companies and how good a job small business plan decision-makers feel that their advisors, their record-keepers, and they do in performing these functions. The purpose of these questions is to determine, from the perspective of the company, how well the system is functioning. This will provide a baseline understanding of the need for additional regulation and provide insights as to what impact such regulation might have.

- How those small companies offering plans feel about the upcoming re-proposed regulation and what impact they believe the regulation would have on the likelihood that they will continue offering plans. In addition, this research also explores how those offering plans might change plan provisions and features if the regulation were to be adopted.

- How those not offering plans, but considering doing so, feel about the upcoming re-proposed regulation and what impact they believe the regulation would have on the likelihood that they will offer plans. In addition, the research examines how they might change the provisions of the plan they are considering if the regulation were to be adopted.

Thus, this research addresses the potential impact of the proposed regulation, in the eyes of employers responsible for offering plans, from several different perspectives.

Methodology

A total of 607 plan decision-makers were administered a 12-minute telephone survey using a sample from Dun and Bradstreet[1] – 505 with defined contribution plans and 102 without. To qualify for the survey, the respondent needed to be either the sole decision-maker or part of a small group of decision-makers regarding the company's retirement plan (or regarding whether or not to offer one) in a company that has been in business for at least two years with over $400,000 in gross revenue.

Companies were split into four size categories based on the number of employees working for the firm – 10 to 49, 50 to 99, 100 to 249, and 250 to 500. Data was weighted to reflect the number of employees nationwide working in each of these size bands.

The study was conducted from November 18th to January 10th by National Research in Washington, DC.

SUMMARY OF FINDINGS

Current Environment

When examining how investment functions are performed in the smaller plan market and how companies evaluate this performance, several key findings suggest that advisors and record-keepers affiliated with plan providers play an important role.

- Roughly 67% rely on an advisor or record-keeper affiliated with a plan provider to provide support in investment selection and monitoring – most rely on the advisor. This is especially the case for smaller companies (employee size 10-49).
- When used, these parties predominately play a primary or collaborative role in investment selection.

But more importantly, a large majority of those responsible for their company's retirement plans give high grades to those helping with investment selection and monitoring, higher grades than they would give themselves:

- A large majority are very satisfied with their plan's current investment choices.
- A large majority say that the advisor or record-keeper does a very good or excellent job in helping in both the selection and monitoring of investments.

[1] Dun and Bradstreet (D&B) maintains a database of over 20 million U.S. businesses. Sources from which D&B compiles the data include, but are not limited to: yellow page telephone directories, credit reports, public records, government registries, financial data, trade directories, web sources and directories, and proprietary files. The compilation is reflective of the population of U.S. businesses by employee size.

- In contrast, around 50% of those surveyed say that they either do or would do a fair or poor job in selecting and monitoring investments themselves.

When asked about the mix of "affiliated" and "unaffiliated" funds they use, on balance respondents report a somewhat greater use of unaffiliated funds.

These findings suggest that employers are generally satisfied with the current system. Furthermore, if the regulation causes companies to try to do more of the investment selection and monitoring themselves, this could be problematic.

<u>Reaction to Proposed New Regulation</u>

When asked a series of questions about the upcoming re-proposed new regulation, those offering plans not only dislike the concept, but also feel that it will impact them to cut back on what they would offer employees:

- Sixty-five percent think the regulation is a bad idea.
- Almost 30% feel it is at least somewhat likely they would drop their plan if this regulation were to go into effect.
- About 80% would likely hire a third party for guidance and over 70% have some concern about whether or not the firm would do a good job.
- A small minority would try to do it themselves, with 51% of these being concerned about how good a job they would do.
- Close to 50% say that it is at least somewhat likely that they would cut back on their match, cut back on investment options, and increase the fees they would charge participants if the regulation were to be passed. Thirty-four percent say it is at least somewhat likely they would spend less money on educating employees and spend less on other benefits.
- Results suggest that the impact of the regulation would be most profound on smaller companies (employee size 10-49).

Those currently not offering a plan but considering offering one say that the upcoming re-proposed regulation would have a negative impact on the likelihood of their offering a plan and on the generosity of the plan they might offer:

- Close to 50% say that the regulation would reduce the likelihood of their offering a plan to some extent – 36% say it would reduce it greatly.
- Close to 50% say that it would be difficult to find an advisor they trust and over 50% say that having to find a third party expert to guide them on investment selection and monitoring would be a major obstacle to the likelihood of their offering a plan.
- Over 40% say that the cost of a third party advisor would be a major obstacle in offering a plan.
- Many say that the regulation would cause them to lower their sights when it came to the type of plan they would offer. A majority say that it would be at least somewhat likely they would offer fewer investment options, raise eligibility waiting times, and reduce employee education efforts. Over 40% say they would likely charge higher fees and not offer a match.

Thus, findings here suggest that the new regulation could have a negative impact on the number of employees who get offered plans and a profound negative impact on the quality and generosity of those plans.

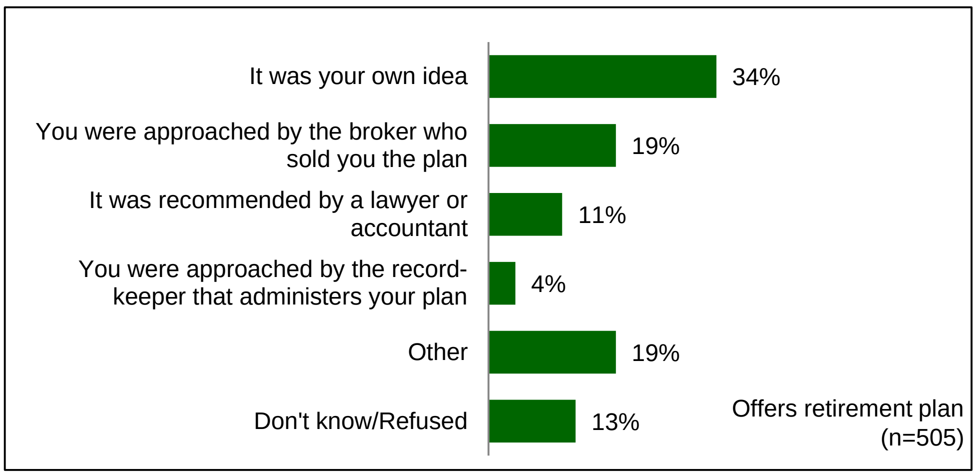
FINDINGS

Those Offering Plans

About the Current Plan

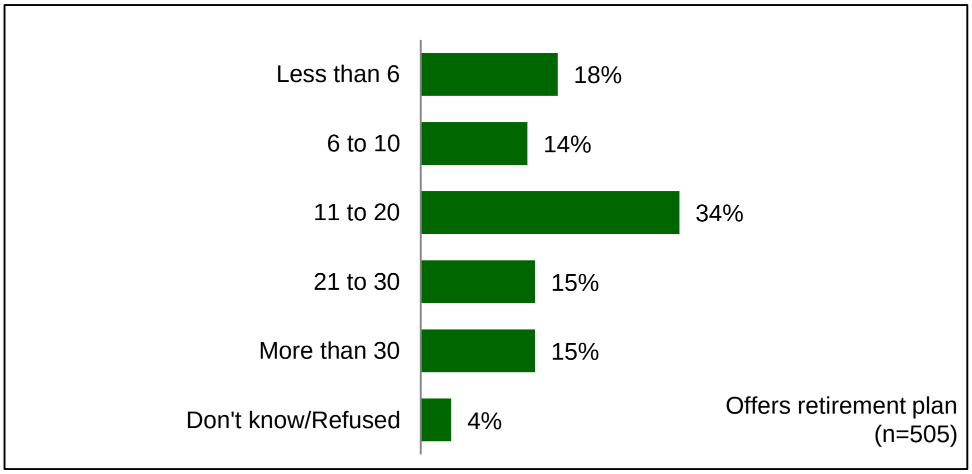
When asked how they came to adapt their current plan, respondents are evenly split between those who report that it was their own idea to do so and those who did so based on the recommendation of someone else, most often the broker selling them the plan.

Figure 1. Which of the following best describes how your company came to consider adopting your retirement plan?



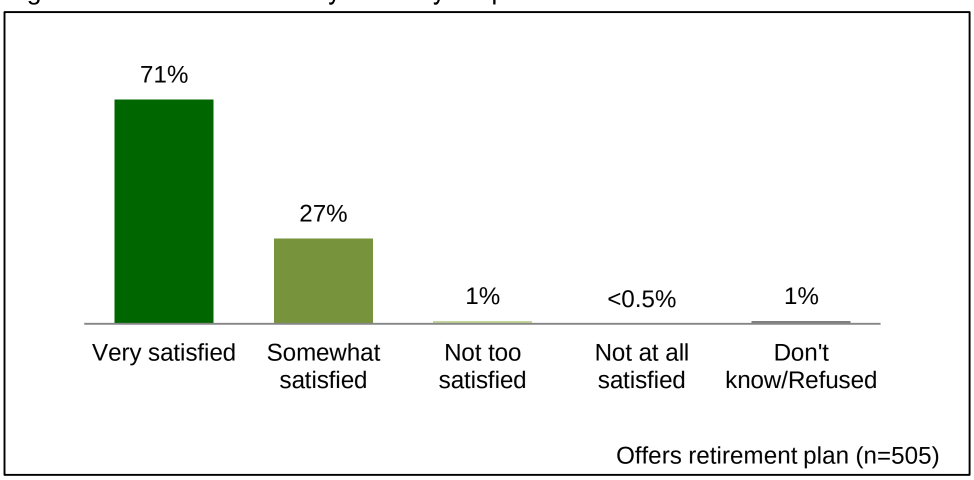
Thirty-two percent report offering ten or fewer options in their plan and 64% report offering more than ten options. The smallest companies (employee size 10-49) are most likely to offer the fewest options with 44% offering ten or fewer.

Figure 2. How many investment options do you offer for your retirement plan?



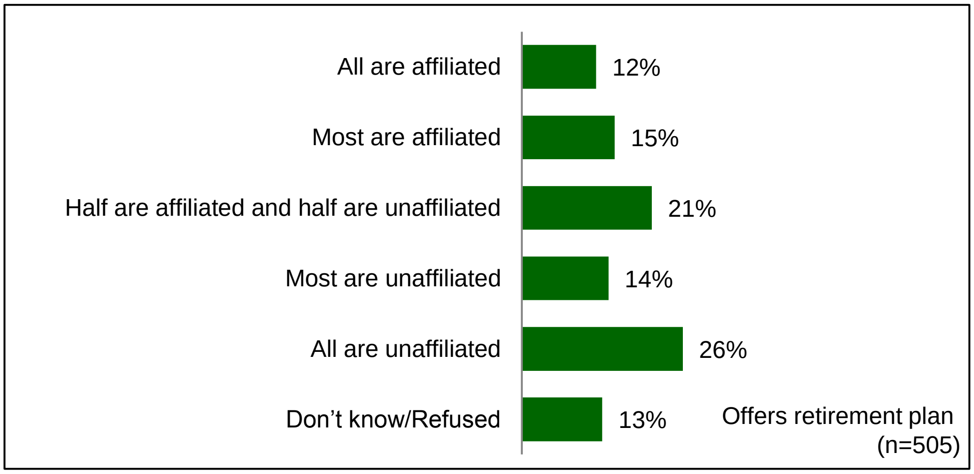
Company plan decision-makers strongly like the investment options in their plans. When asked how satisfied they are with their current investment options, 71% report that they are very satisfied and almost all the rest say they are somewhat satisfied.

Figure 3. How satisfied are you with your plan's current investment choices?



Company plan decision-makers were asked to describe the composition of their investments in terms of the proportion of funds that are "affiliated" with the provider (manufactured by the provider) or "unaffiliated" (manufactured by someone else). On balance, more funds are "unaffiliated." A little over 25% say that all (12%) or most (15%) of their fund are "affiliated." In contrast, 40% say that most (14%) or all (26%) of their funds are "unaffiliated." Twenty-one percent say their fund mix is half and half. Smaller companies (employee size 10-49) are slightly more likely to have all "affiliated" funds – 19% do so.

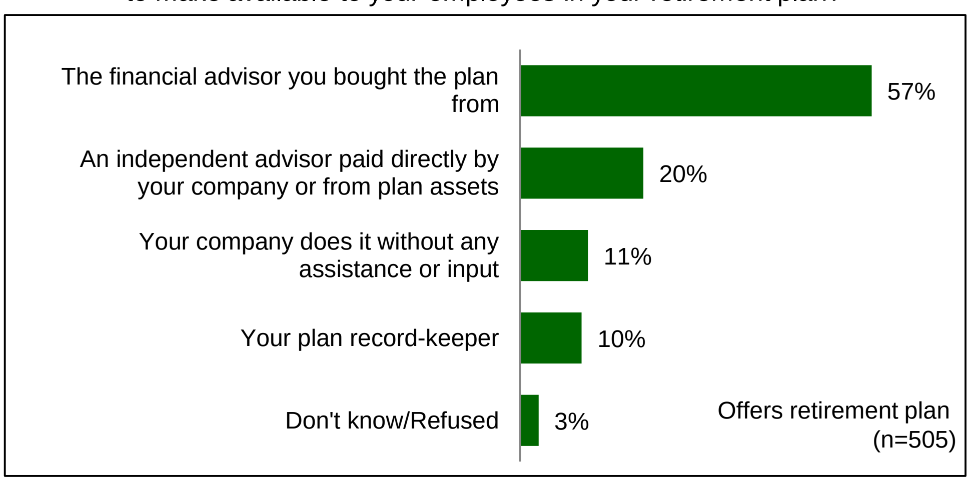
Figure 4. Thinking about the funds you offer your employees, what proportion fall into these categories (affiliated and unaffiliated)?



Role of Advisor and Record-keeper

Advisors play a major role in supporting the company's investment functions. When asked who they most closely work with to decide what investment options to offer, 57% say it is the advisor who sold them the plan, and another 10% say that it is the plan record-keeper. Only 20% hire an independent advisor, and 11% make investment selections themselves without any support. Smaller companies (employee size 10-49) are less likely to use an independent advisor, with only 11% doing so. Larger companies (employee size 250-500) are less likely to use the plan provider advisor, with only 40% doing so.

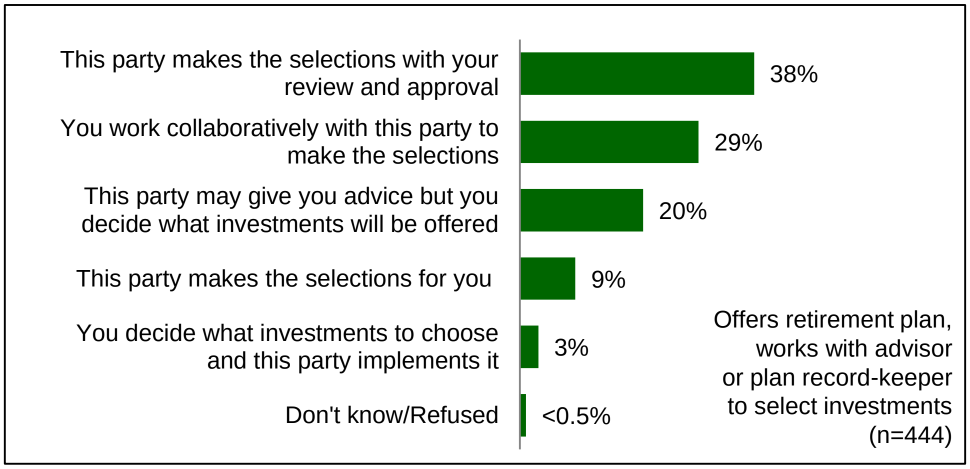
Figure 5. Who do you work with most closely to decide what investment options to make available to your employees in your retirement plan?



The plan provider advisor or record-keeper plays an important role in the investment selection process. Among those that use any type of third party, close to 50% have the party make the investment selections either with (38%) or without (9%) the employer's approval. Another 29%

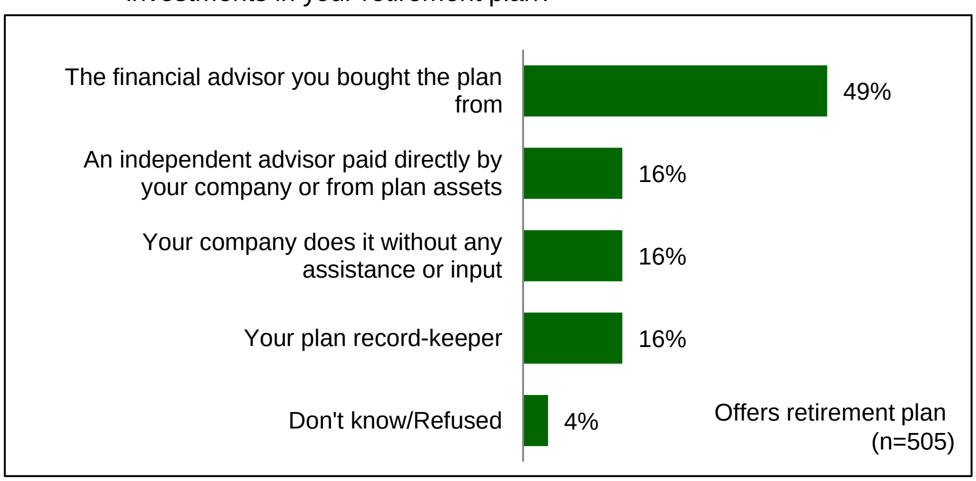
work collaboratively with the third party. Less than 25% take the lead in making the selections either with third party advice (20%) or just using the third party for implementation (3%).

Figure 6. Which best describes the role that the plan record-keeper/advisor plays?



When asked who plays the primary role in monitoring the performance of investments in the plan, 49% say it is the advisor who sold them the plan and 16% say that it is the plan record-keeper. Similarly, 16% say they do it themselves and another 16% hire an independent advisor. As with selecting investments, smaller companies (employee size 10-49) are less likely to use an independent advisor to monitor investments (only 11%) and larger companies (employee size 250-500) are less likely to use the plan provider advisor (34%).

Figure 7. Who plays the primary role in monitoring the performance of the investments in your retirement plan?



Views Towards Advisors and Record-keepers

As previous data suggests, most are satisfied with their plan line-up and rely greatly on their advisor or record-keeper for support in this area. Thus, it is not surprising that most give high grades to the advisor or record-keeper when it comes to working with the plan.

In the area of selecting or helping to select investments, over 80% evaluate this party as excellent (40%) or very good (42%). Another 13% rate this party as good. Only 4% evaluate the job done by this party as fair or poor. In the area of monitoring and, if necessary, changing the plan line-ups, 75% evaluate this party as excellent (35%) or very good (40%). Another 17% rate this party as good. Only 6% evaluate the job done by this party as fair or poor.

Figure 8. How good a job do you think your plan record-keeper/advisor does in selecting/helping you select investments for your retirement plan?

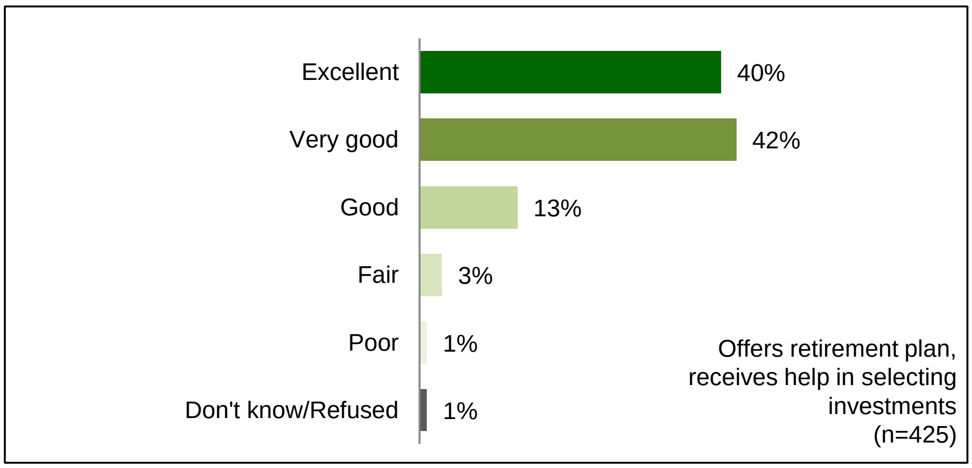
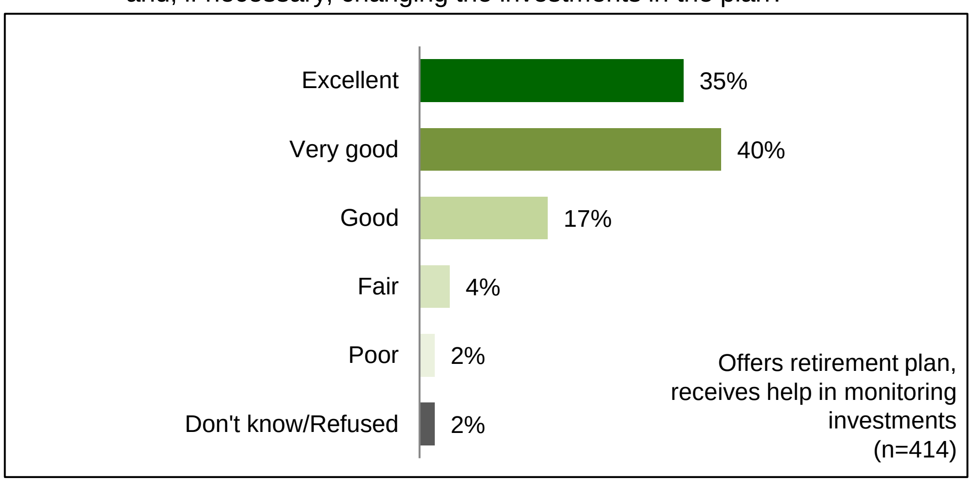


Figure 9. How good a job does your plan record-keeper/advisor do in monitoring and, if necessary, changing the investments in the plan?



In contrast, company retirement plan decision-makers give themselves low grades for doing investment functions themselves. When it comes to how they do in selecting investments for the plan or the job they would do if they were to play this role, 47% say that they do or would do a fair or poor job. Only 20% say they do or would do an excellent (6%) or very good (14%) job.

When it comes to how they do in monitoring and adjusting investments or the job they would do if they were to play this role, 53% say that they do or would do a fair or poor job. Only 18% say they do or would do an excellent (4%) or very good (14%) job.

Figure 10. How good a job do you do (or would you do) in selecting investments for the plan?

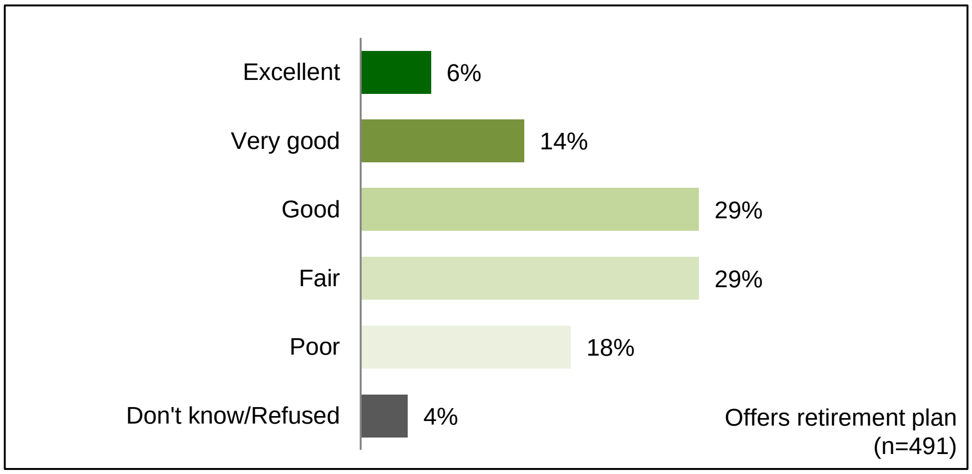
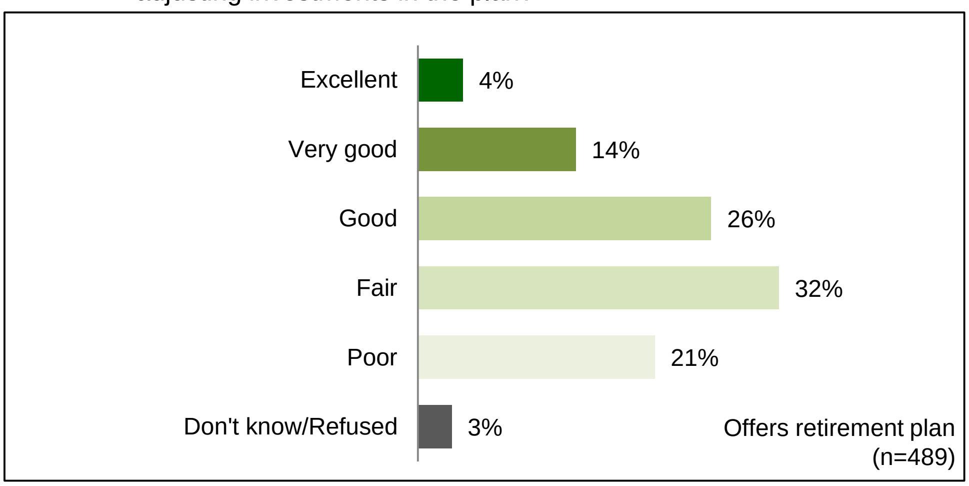


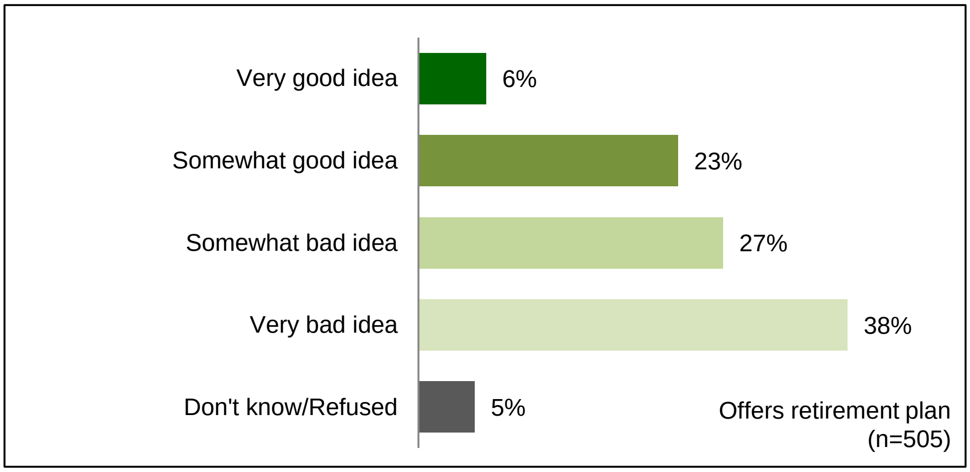
Figure 11. How good a job do you do (or would you do) in monitoring and adjusting investments in the plan?



Reaction to Proposed New Regulation

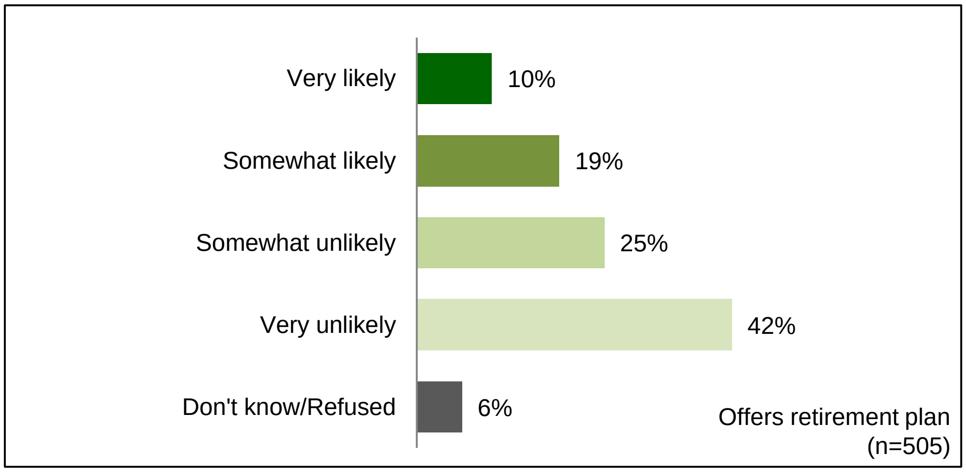
In general, small business plan decision-makers do not like the regulation proposed by the Department of Labor as presented to them. Respondents were given a description of the new regulation (See Appendix 1) and asked for their reaction. Overall, 65% consider it to be either a very bad idea (38%) or a somewhat bad idea (27%). Only about 29% consider it to be a very good idea (6%) or a somewhat good idea (23%). Larger companies (employee size 250-500) are more likely to think that the regulation is a good idea with 40% feeling it is at least a somewhat good idea. In contrast, only 26% of smaller companies (employee size 10-49) think the regulation is at least a somewhat good idea.

Figure 12. What is your reaction to this new regulation?



The research suggests several consequences that the new law might create. One is that a significant minority might drop their plans. When asked how likely they would be to drop their plan if this new regulation was implemented, close to 30% claim that it would be very likely (10%) or somewhat likely (19%) that they would. Over 65% say it is very likely (42%) or somewhat likely (25%) that they would not. Smaller companies (employee size 10-49) are the most likely to say that they would be very (13%) or somewhat (22%) likely to drop their plans.

Figure 13. If this regulation were implemented, how likely is it that you would drop your plan? Would you say that it is…



Another potential consequence is that many of these plan decision-makers may not trust their ability to choose the right advisor. When asked whether they would hire a third party to select and/or monitor funds, over 80% say that they would definitely (38%) or most likely (44%) do so. Only slightly over 10% would definitely (4%) or most likely (8%) do it themselves. Among this large majority that would hire another party, 76% are at least somewhat concerned about the fiduciary risk they might face in picking a firm that would not do a good job. Smaller companies (employee size 10-49) express the most concern with 82% being at least somewhat so.

Figure 14. If this regulation were implemented and you were to keep your plan, what would you do when it came to selecting and/or monitoring funds? Would you…

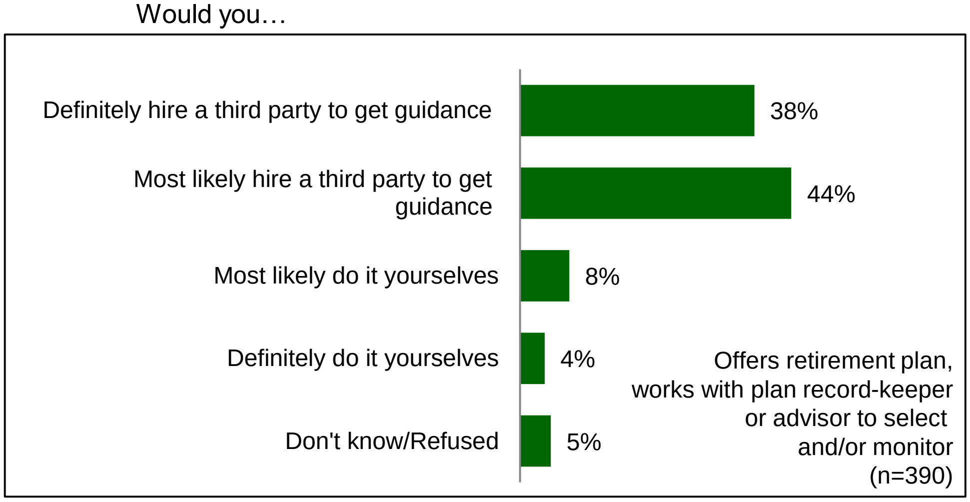
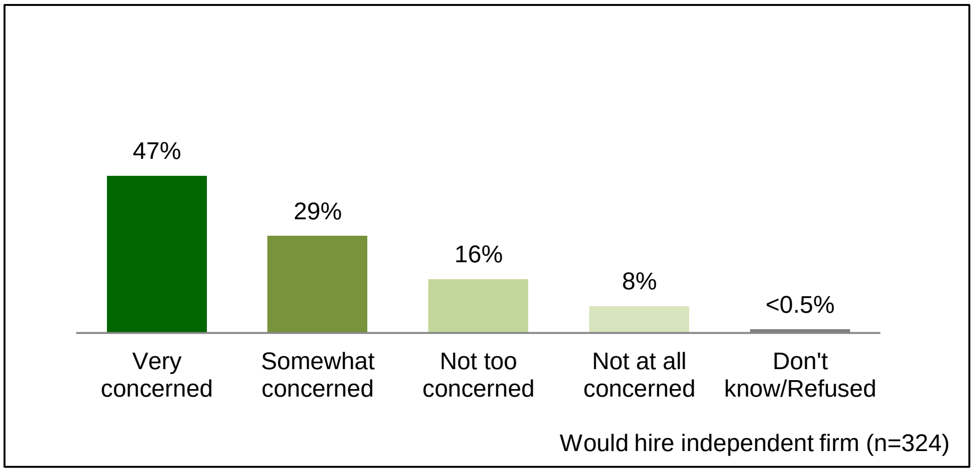
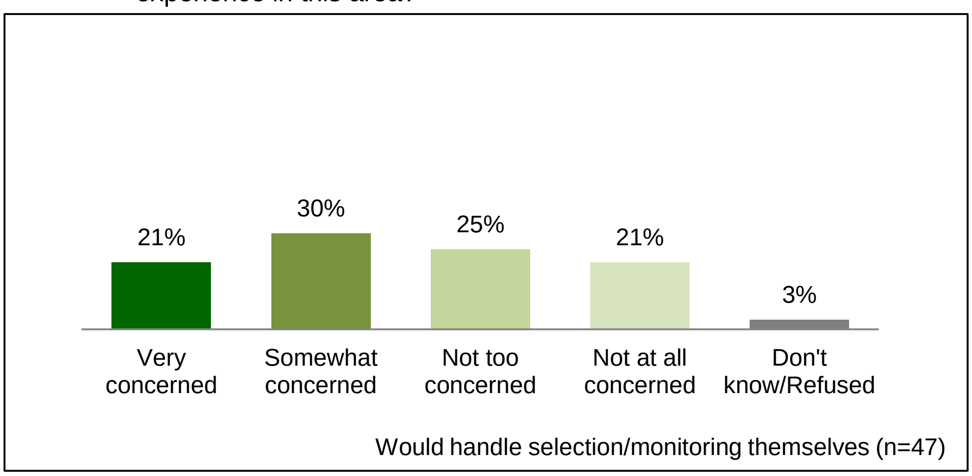


Figure 15. Assuming you were to hire an independent firm to select and/or monitor investments, how concerned would you be about the fiduciary risk you might face of picking a firm that would not do a good job?



Of the small minority who would select and/or monitor the investments themselves, 51% are very or somewhat concerned about the fiduciary risk they face of making bad decisions based on their lack of experience in the area.

Figure 16. Assuming you were to select and/or monitor investments yourself, how concerned would you be about the fiduciary risk you might face of making bad decisions or having liability based on your lack of experience in this area?

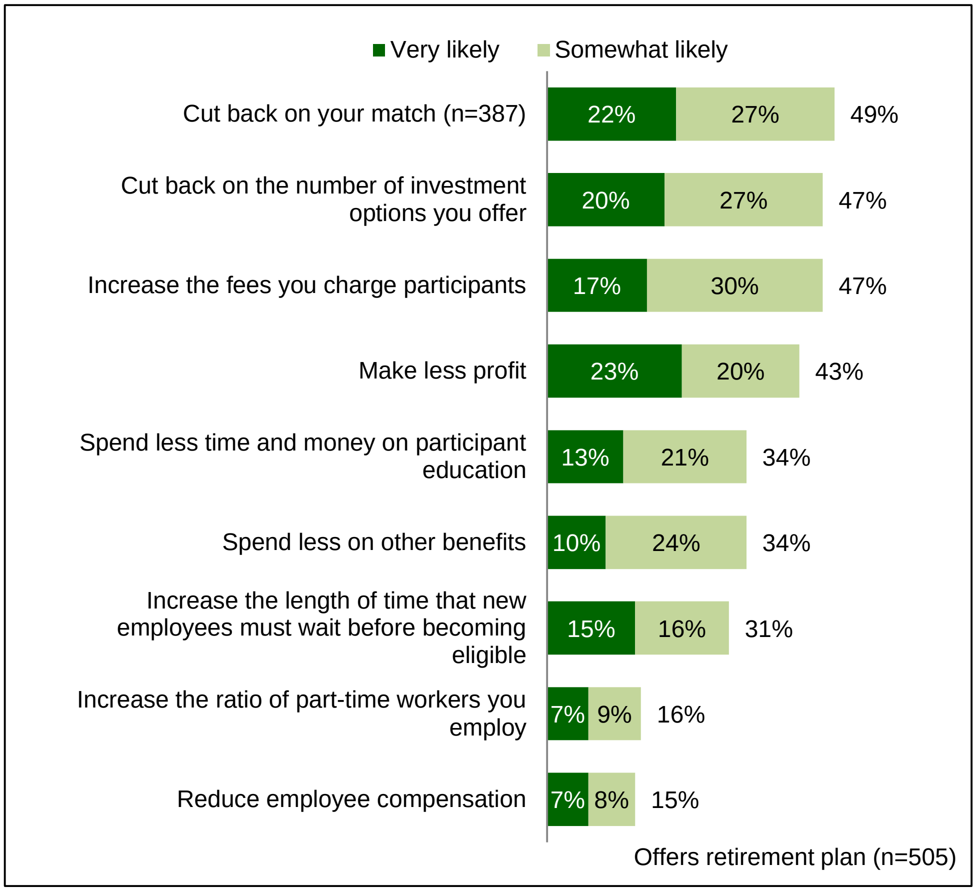


Even if small company plan managers do not drop their plans, this research suggest that significant numbers would take actions that would have negative financial consequences for their employees. Close to 50% each say that it is at least somewhat likely that they would cut back on their employee match (49%), that they would cut back on the number of investment options they offer (47%), and that they would increase plan fees (47%). Roughly 33% each say it would be at least somewhat likely that they would spend less on other benefits (34%), that they would spend less time on participant education (34%), and that they would increase the eligibility waiting time (31%) for the plan.

Smaller companies (employee size 10-49) are the most likely to consider making some of these cutbacks. Roughly 40% would spend less time and money on participant education (41%), spend less on other benefits (40%) and increase the eligibility waiting time (39%).

In addition, over 40% say that it is at least somewhat likely they would make less profit (43%).

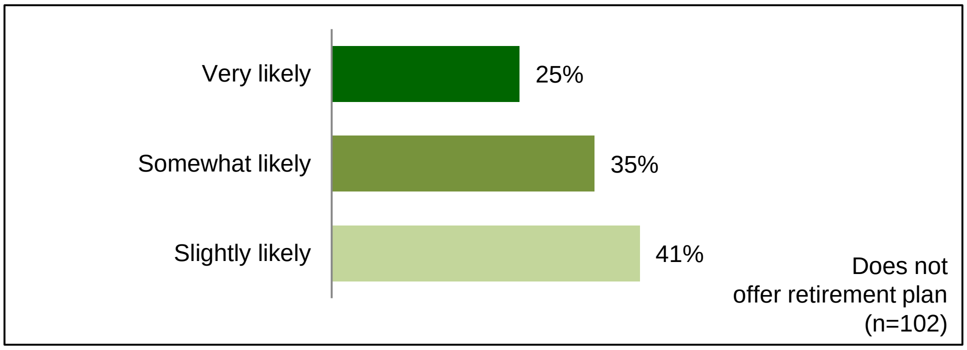
Figure 17. How likely is it that the increased cost and risk of fiduciary liability associated with this regulation would cause you to…



Impact of Regulation on Those Considering Starting a Plan

This study also interviewed 102 employers who would at least share in the decision-making authority to start a plan for their companies and who reported that they would be at least slightly likely to start a plan for their company. Of these, about 60% were at least somewhat likely to start a plan and 41% were slightly likely.

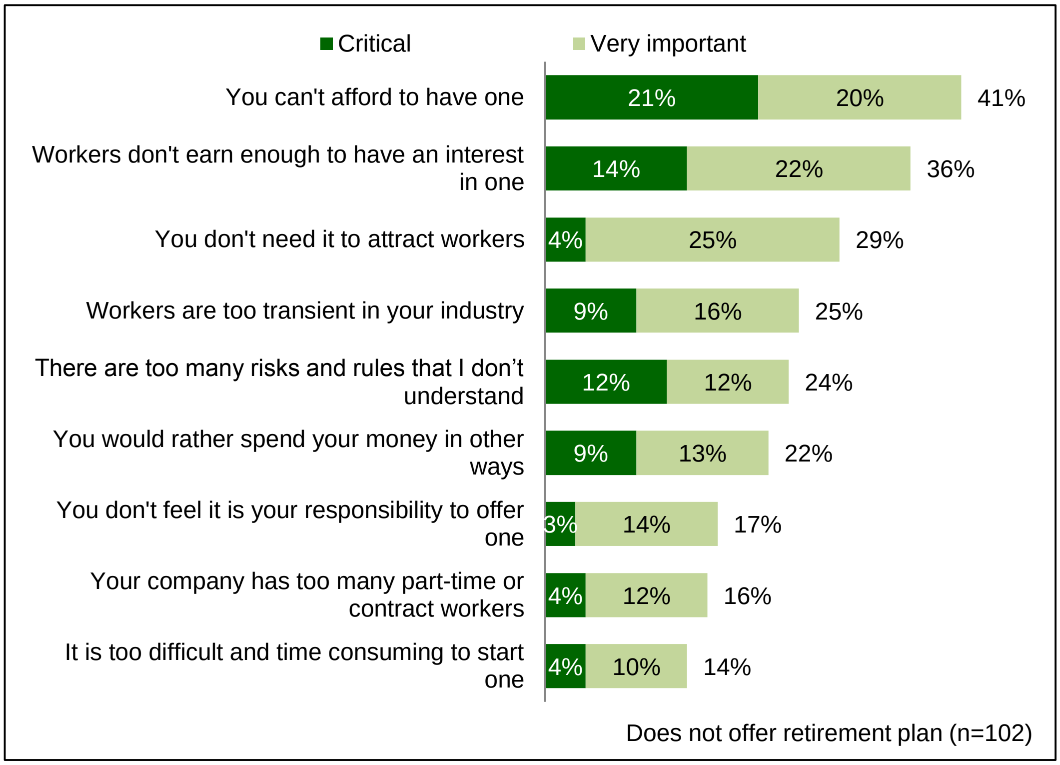
Figure 18. How likely is it that you will start a retirement plan, such as a 401(k) plan or 403(b) plan, for your company in the next five years?



Among these employers, the most common reason they do not start a plan is that they cannot afford to have one. Forty-one percent consider it to be a very important or critical reason. The second most important reason is that workers do not earn enough, with 36% of employers considering this to be at least very important. Other somewhat less frequently cited reasons include that they don't need it to attract workers and that workers are too transient.

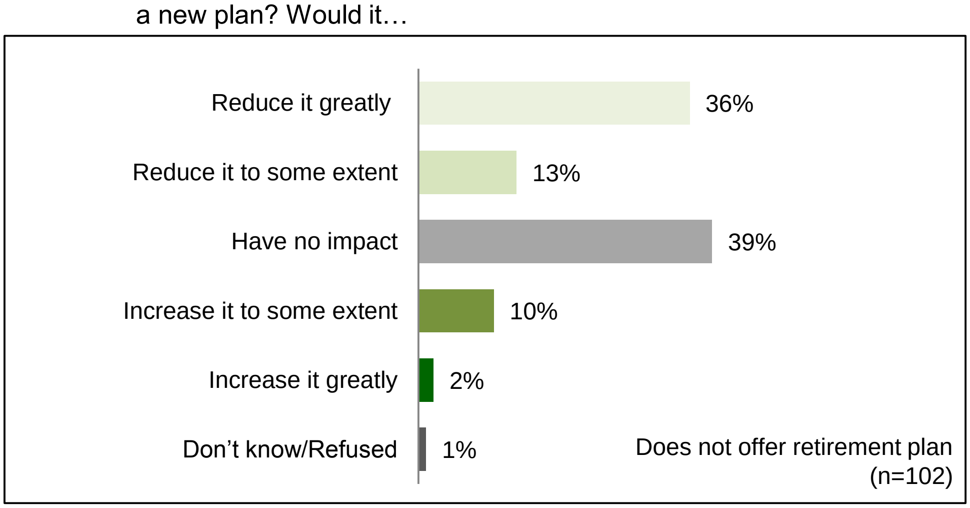
One interesting finding is that 24% cite the number of risks and rules that they don't understand as a very important or critical reason for not offering a plan.

Figure 19. How important are each of the following reasons for why you don't offer a plan…



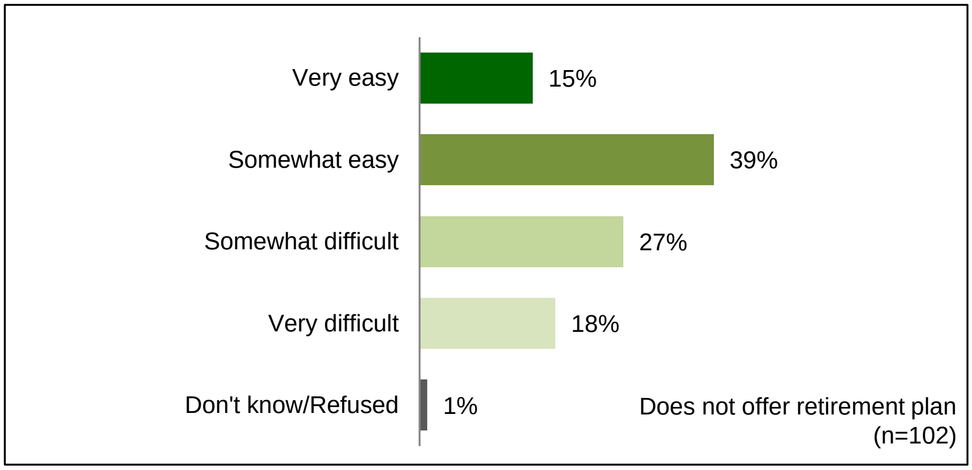
These employers were given the same description of the proposed Department of Labor regulation (See Appendix 1) and asked what impact such regulation would have on the likelihood that they would start a plan. Close to 50% claim that it would reduce their likelihood a great deal (36%) or to some extent (13%). Another 39% say it would have no impact. Twelve percent say it would increase their likelihood of starting a plan.

Figure 20. What impact would this new regulation have on your likelihood to start a new plan? Would it…



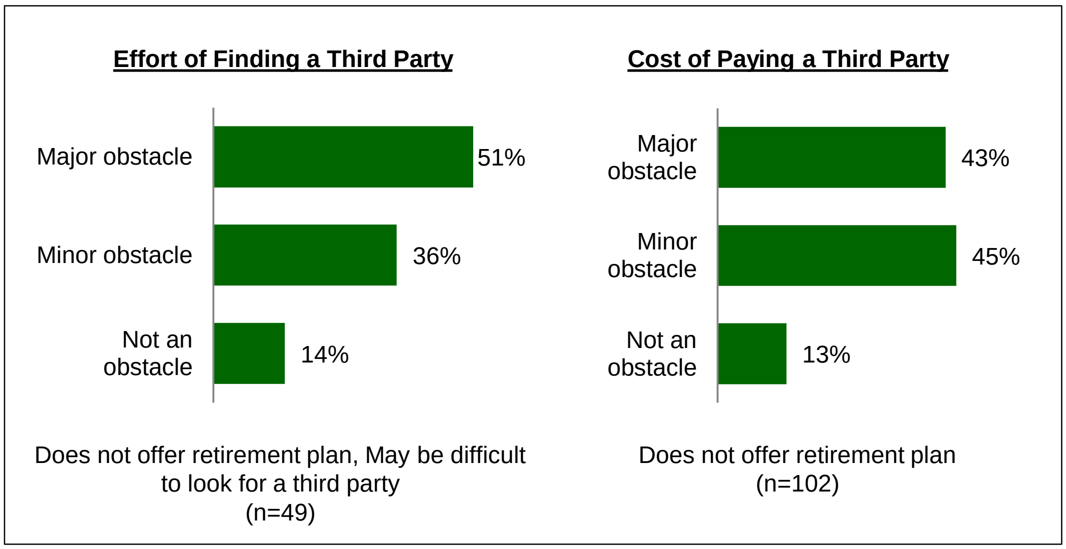
When asked how easy or difficult it would be to look for a third party expert they trust to provide investment guidance, over 50% of those responsible for the decision of starting a plan say it would be very (15%) or somewhat (39%) easy, and over 40% say that it would be very (18%) or somewhat (27%) difficult.

Figure 21. How easy or difficult do you think it would be to look for a third party expert you trust to provide guidance on the selection and monitoring of investment options…



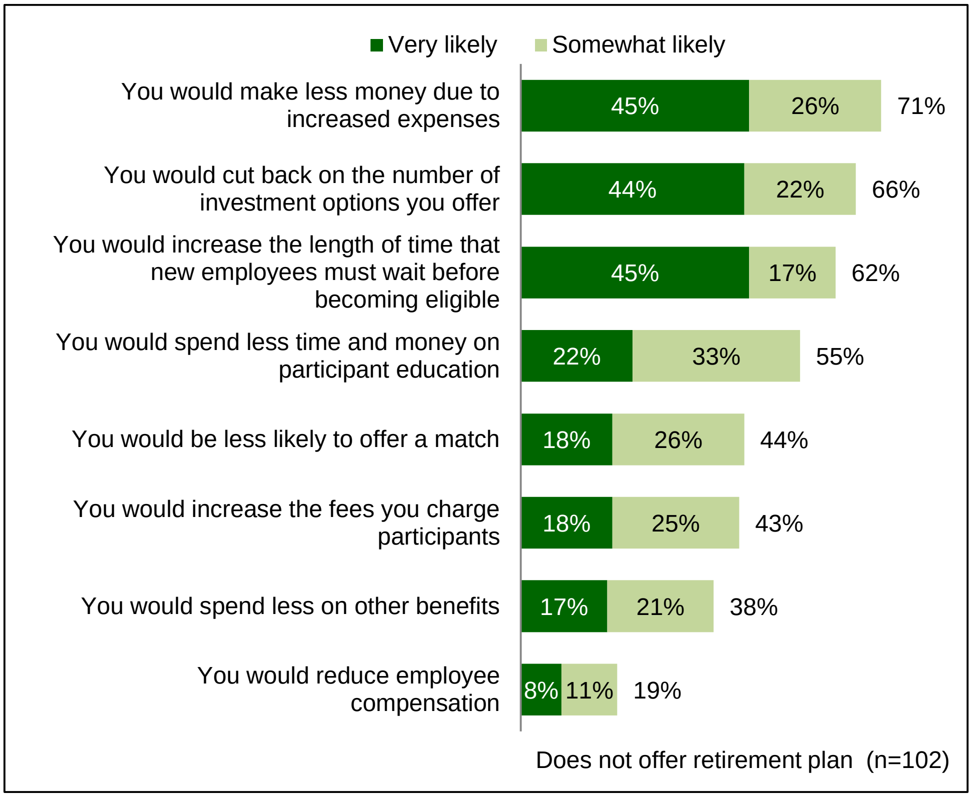
Nonetheless, the effort and cost involved in finding a third party expert does have a dampening effect on the likelihood of starting a plan. When asked how big an obstacle the effort and potential liability involved in finding a third party expert would be on their likelihood of offering a plan, 51% say that it would be a major obstacle. Forty-three percent say that the cost would be a major obstacle.

Figure 22. How big an obstacle would the effort and potential liability involved in finding a third party expert to provide guidance on the selection and monitoring of investment options be on your likelihood of offering a plan…
How big an obstacle would the cost of paying a third party expert to provide guidance on the selection and monitoring of investment options be on your likelihood of offering a plan…



As with those already offering plans, the impact of the new regulation goes beyond the decision of whether or not to offer a plan for those considering one. It also impacts how generous the plan they are considering may be, and the impact is stronger than found for those already offering plans. Over 60% each say that the regulation would be at least somewhat likely to cut back on the number of investments they would offer (66%) and increase the eligibility waiting time (62%) Over 40% say they would be at least somewhat less likely to offer a match (44%) and at least somewhat likely to increase participant fees (43%). Seventy-one percent say it would cause them to make less money.

Figure 23. If you were to start a new plan, how likely is it that the cost and potential liabilities required by the new regulation would have the following impact…



Respondent Demographics

Figure 24. Average age of employee population

	Offers plan (n=505)	**Does not offer plan** (n=102)
30 or younger	11%	12%
31 to 35	19	34
36 to 40	24	25
41 to 45	27	11
46 or older	16	17
Don't know /Refused	3	1

Figure 25. Percentage of work force that is part time

	Offers plan (n=505)	**Does not offer plan** (n=102)
0%	31%	34%
1 to 9%	36	17
10 to 19%	10	14
20 to 29%	7	7
30 to 39%	5	11
40 to 49%	3	2
50 to 59%	3	2
60 to 69%	1	1
70 to 79%	2	4
80 to 89%	1	7
90 to 99%	<0.5	2
100%	--	--
Don't know /Refused	<0.5	--

Figure 26. Types of retirement plans offered

	Offers plan (n=505)
401(k) plan	84%
403(b) plan	13%
Profit sharing plan	24%
ESOP or stock bonus plan	5%
Some other type of retirement plan	15%

Figure 27. Percentage of full-time employees that are eligible to participate in 401(k) or 403(b) plan(s)

	Offers 401(k) or 403(b) (n=484)
Less than 10%	<0.5%
10 to 19%	1
20 to 29%	1
30 to 39%	<0.5
40 to 49%	2
50 to 59%	3
60 to 69%	3
70 to 79%	6
80 to 89%	9
90 to 99%	19
100%	55
Don't know/Refused	1

Figure 28. Percentage of plan participants that are currently contributing part of their income to the plan(s)

	Offers 401(k) or 403(b) (n=484)
Less than 10%	5%
10 to 19%	5
20 to 29%	7
30 to 39%	7
40 to 49%	7
50 to 59%	10
60 to 69%	11
70 to 79%	14
80 to 89%	11
90 to 99%	10
100%	10
Don't know/Refused	2

APPENDIX 1

Description of Proposed Regulation

Now I want to describe a proposal for a new government regulation. As a plan sponsor, your company currently has a fiduciary responsibility to act in the best interest of your employees when it comes to the investment choices that are available in the company retirement plan. This includes using a prudent process to select a reasonable group of investment funds and monitoring fund performance. Companies have liability to the extent that they do not meet the ir fiduciary duties.

Currently, many employers depend on their plan provider or advisor to provide assistance on the selection and monitoring of funds they offer employees. Such use of assistance is permissible under the fiduciary rules as long as it is prudent to do so. The Department of Labor is considering prohibiting both retirement plan providers and the advisors who sell retirement plans to employers from assisting the employers in the selection and monitoring of the funds in the retirement plan. Under possible new rules, the employer would have two options: (a) find an independent expert on investments to provide, for an additional fee, guidance on the selection and monitoring of investment options, or (b) do the selection and monitoring themselves, subject to fiduciary liability if this selection is not done in a prudent manner by someone with sufficient expertise. If “a” is chosen, the plan sponsor would be subject to fiduciary liability if the expert is not chosen in a prudent manner.