INNOVEST'S **RESEARCH** REPORT

A NEWSLETTER BY INNOVEST

FALL | 2018

IN THIS ISSUE:

NEW CLIENTS

Innovest was recently selected to provide investment consulting services for:

Adams County

AlloSource

City of Gilbert, AZ

It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and in the Client Spotlight are listed with their approval and permission.

WHAT YOU NEED TO KNOW ABOUT MISSING PARTICIPANTS

Marianne Marvez, RPA
Vice President

It has long been a challenge for employers to keep track of employees once they are no longer on the payroll. People may relocate, marry, divorce, change their names and ultimately pass on Couple that with the mobility of the 21st Century workforce and the increased use of auto programs, employers find themselves with an ever-increasing population of missing or unresponsive former employees; many of whom are not even aware that they have a balance in their former employer's retirement plan.

In 2016 the Philadelphia office of the Department of Labor (DOL) implemented a pilot program to address the growing issue of missing participants. The DOL audited pension plans whose form 5500s indicated they had a significant number of terminated vested participants who were not receiving pension payments. The employers explained to the DOL that these former employees were either lost or had not responded. Under the pilot program, the DOL sent certified letters to the last known addresses of these former employees. As a result, between October 2016 and August 2017 the DOL recovered more than $165 million in pension benefits that should have been paid to these individuals. Many of the located individuals did not know that they were owed a benefit under their former employer's pension plan. This pilot program proved that many employers simply were not making an effort to locate missing former employees.

The DOL estimates that tens of thousands of participants lose track of an estimated $850 million in 401(k), 403(b), 457 and other defined contribution assets each year. These missing former employees are still considered plan participants under the law. The Internal Revenue Service (IRS), DOL, and the Pension Benefit Guaranty Corporation (PBGC) have made it clear that it is the employer's responsibility to find these former employees. These agencies have emphasized the importance of employers maintaining and documenting a prudent process to verify the efforts made to find missing or unresponsive former employees with an account balance in the plan. Further, the DOL has stated that by not maintaining and documenting their process, a plan sponsor could be deemed to have breached their fiduciary duty under the plan.

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The problem is there is not any clear regulatory guidance on what constitutes a prudent process.

What's a plan sponsor to do? Industry advocacy groups suggest using the regulatory guidance written for similar issues and apply it to the current situation.

IRS Guidance

On October 19, 2017, the IRS issued guidance on the appropriate steps to locate missing participants for purposes of required minimum distributions. The memorandum states that if an employer follows the three steps outlined below, the IRS examiner will not challenge a plan for failure to make a required minimum distribution to a missing participant or beneficiary to whom the payment is due. The section below is taken from the IRS Guidance Memorandum.

1. Search the plan and related plan, sponsor, and publicly available records or directories for alternative contact information;
2. Use any of the following methods:
    - A commercial locator service;
    - A credit reporting agency; or
    - A proprietary internet search tool for locating individuals; and
3. Attempt to contact via United States Postal Service (USPS) certified mail to the last know mailing address and through appropriate means for any address or contact information (including email addresses and telephone numbers).

DOL Guidance

As described above, the DOL has aggressively been seeking out employers who have missing participants for audit. Some DOL auditors have asserted that:

1. Failure to locate a missing participant may be considered a breach of fiduciary duty, even if the plan's procedures have been followed.
2. Forfeiture of retirement plan benefits owed to missing or unresponsive participants may result in a prohibited transaction, even if the plan document provides for reinstatement of the forfeited benefit upon the employee's return or claim for benefits.
3. Plan sponsors should perform an annual search for lost participants and use a different search method each year, including contacting existing or former employees who may have known or stayed in contact with the missing employee. DOL auditors have claimed that employers must do whatever it takes to locate missing participants or get them to respond.
4. Plan sponsors should keep searching for these lost plan participants indefinitely, even if doing so is not an efficient use of plan resources.

As a result of these findings, the Employee Benefits Security Administration (EBSA) recommends following four steps in locating missing participants with a vested account balance until further guidance is issued by the DOL:

1. Send missing participants a certified letter using their last known address.
2. Keep documentation of the efforts used to reach missing participants.
3. Contact co-workers of missing participants to see if they know how to contact the individual.
4. Try contacting the missing participant using their cell phone number or personal email addresses, as most individuals keep their cell phone numbers and personal email address when they relocate.

In addition, employers should check other benefit plans and try to contact the participant's beneficiary. Employers can also try using a commercial locator service, a credit reporting agency or other internet search options. During their pilot program the DOL demonstrated that sometimes a simple Google search will find the employee in a matter of minutes, thereby negating an employers' excuse for not locating lost employees.

PBGC Guidance

The PBGC has expanded its missing participant program for defined benefit (DB) plans to include terminating defined contribution (DC) plans. DC plans that are terminating and have lost participants with account balances may now transfer those benefits to the PBGC instead of opening an IRA account at a financial institution. This option only applies to terminating plans.

Uncashed Checks Guidance – Because uncashed DC or DB plan benefit checks may be considered plan assets, employers need to have procedures in place for handling uncashed checks as part of their search for missing participants. These uncashed funds may continue earning income for the plan's service provider, which may add to the plan sponsor's fiduciary concerns.

Due to the increased scrutiny by the IRS and DOL to find missing participants, plan administrators and plan sponsors need to be sure they have ongoing processes and procedures in place for locating missing participants with account balances and for handling uncashed checks. Consider anchoring the process to an event such as the annual force-out program (where participants with balances between $1,000 and $5,000 may be rolled over to an IRA), or to the annual solicitation of required minimum distributions. Tying the process to an event will help make sure the process is followed every year. As always be sure to **document, document document.**

ARCHITECTS OF CHOICE: BUILDING BETTER PARTICIPANT OUTCOMES

Abigail Thomas
Lead Senior Analyst

Choice architecture is the practice of influencing choice by changing the way options are presented to people. The concept was highlighted by Richard Thaler and Cass Sunstein in their 2008 book *Nudge: Improving decisions about health, wealth, and happiness.* As a plan sponsor, you may frequently find yourself in the role of a choice architect. Your job is to present participants with choices: participation, savings rate, investment options, education opportunities, and more. The *way* you present these choices can have a substantial impact on participants' experience and outcomes.

Active choice is a way of presenting a choice that requires participant engagement. For example, active choice enrollment requires employees to actively make the decision to participate, or not, in their retirement plan. This approach differs from the other enrollment processes which allow participants to default into a state of participation. Once defaulted, procrastination may keep participants from changing deferral rates or enrollment status.

Active choice enrollment can be presented to employees along with other new-hire or open enrollment period materials that require being completed or returned within a specified period. Employees decide between two options: *Enroll or Waive; Yes, I want to participate or No, I do not want to participate, etc.* If participants choose to participate, they are prompted to make contribution rate decisions immediately or in the near future.

Active choice can also be used to encourage participants to make a change to their existing retirement plan. Decisions around contribution increases or investment options can be presented in a similar way, creating a necessary choice between sticking with the status quo and making a positive change.

Enhanced Active Choice

Active choice can be constructed to include language that invokes an emotional response from potential participants. Known as *enhanced* active choice, this process adds descriptive language to the decision. The participant must choose between such statements as *Yes, I want to take this step toward enjoying a comfortable lifestyle for the rest of my life, even if I stop working* and *No, I do not want to take this step toward a comfortable lifestyle, knowing someday I will have to stop working.*

Building the decision in this way taps into human instinct, highlighting the possible positive and negative effects of this choice in a relatable way. Enhanced active choice messaging can make participants feel their employer cares about them and they could rely on the company if they needed assistance in making saving decisions. Plan sponsors who adopt enhanced active choice should be sure to not use language that implies any guarantee of success or failure.

Active Choice Case Study: Online Enrollment

A Colorado municipality was searching for a way to increase participation in their 457 retirement Plan. The Plan Committee could not reasonably implement auto enrollment due to the City's statutes. Instead, the Plan implemented active choice enrollment, replacing a traditional opt-in method. The process was first rolled out to new hires in the first part of 2017. Enrollment in the 457 Plan was included in online benefit programs, thanks to a customizable HR system implemented earlier that year.

In November of 2017, the Committee included 457 enrollment in their open enrollment process for other employee benefits. All active employees saw the 457 Plan election and needed to make an active choice regarding plan participation, regardless of participation status prior to the open enrollment period.

The selection screen defaulted to enroll in the plan at a 3% deferral rate. Enhanced language was used with the enroll option reading "Choose now to start saving for a comfortable lifestyle for the rest of your life by electing to contribute to the 457 Retirement Plan."

The average enrollment from 2014 to 2016 was 48 new enrollments per month. During 2017, the average new enrollments increased to 75 per month – a 56% increase. Contributions also increased 13.4% year-over-year for the same time period, with 42% of active employees increasing contribution rates.

The plan had 696 new enrollments due to the November 2017 open enrollment process, with an effective date of January 2018. There were 8,198 non-participating employees during this period, which means that 8.5% of these employees elected to begin contributions after open enrollment. Of the new enrollments, 303 were employees who had been with the employer for more than five years.

Active choice architecture helped boost the plan's overall participation rate from a stagnant **37%** in the 2014 to 2016 time period, to **42%** as of July 30, 2018.

Active Choice Case Study: Paper Form

A municipality in Colorado was interested in implementing active choice in their 457 Plan enrollment process. Because their payroll and HR systems would not support incorporation of this process in an online enrollment process, the Committee created an easy enrollment form.

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The form, shown below, incorporated enhanced active choice and an increase contribution option for participants who were already participating.

ENROLLMENT

☐ **Yes, I want to save or increase my savings in my future in order to enjoy a comfortable lifestyle in retirement.**

I want to start my savings*
Select a percentage or enter dollar amount per pay period

☐7% OR ☐$________
☐5%
☐3%
☐Other _____% (whole percentages only)

*Your pre-tax contribution will be invested into a target date portfolio closest to the year you turn 65. You can change your investment at any time using EZLink.

I have already started and want to increase my savings to:
Select a percentage or enter dollar amount per pay period

☐7% OR ☐$________
☐5%
☐3%
☐Other _____% (whole percentages only)

*Your increase will be invested in the same manner as your investment allocation at the time of the increase. You can change your investment at any time using EZLink.

☐ **No, I don't want to save for a comfortable lifestyle after I stop working.**

Additionally, the form used anchoring – a cognitive bias that occurs when individuals use an initial piece of information to make subsequent judgments. By providing three contribution levels, the Committee not only provided an implicit recommendation that these rates are good choices, but that a rate between 3% and 7% is standard. Participants subconsciously compared their eventual contribution rate decision against this range to judge its suitability.

Also, the Committee utilized a bias known as central tendency. When choosing from a range of options, respondents will lean towards what they see as both the least extreme and most common choice – the one in the middle.

Using an active choice structure can be a simple way to drive employee participation and engagement in retirement savings program. Put simply, utilizing active choice can improve your participants' likelihood to enjoy a comfortable retirement.

NONPROFIT SPOTLIGHT

ASSOCIATION OF PERIOPERATIVE REGISTERED NURSES (AORN)

The Association of perioperative Registered Nurses (AORN) is the world's largest professional association for perioperative nurses. Perioperative is defined as the time surrounding surgery including intake, anesthesia, surgery and recovery. Founded in 1949, AORN aims to make surgery safer for patients. AORN's mission is, "to promote safety and optimal outcomes for patients undergoing operative and other invasive procedures by providing practice support and professional development opportunities to perioperative nurses."

AORN provides numerous resources to their members, including education, career development, leadership training, and facility and health system solutions. Their resources range from articles to podcasts and are designed to make surgery safer and standardized practices around the industry. They also host events throughout the country to teach current best practices and provide continuing education. In addition, AORN creates study guides and tips for relevant certifications including the Certified Ambulatory Infection Preventionist (CAIP) and the Certified Administrator Surgery Center (CASC).

The AORN Foundation is the philanthropic arm of AORN that provides funding for academic scholarships, professional development grants and patient safety resources. AORN Foundation helps nurses realize their dreams of higher education and/or professional certification.

Innovest is proud to provide consulting services to AORN and the AORN Foundation!

AORN BY THE NUMBERS

42,000 AORN members

Represent the interest of more than **160,000** perioperative nurses

275 U.S. chapters

AORN FOUNDATION BY THE NUMBERS

In 2017 the AORN Foundation provided:

85 academic scholarships

1,331 grants for professional development

More than **$1.3 million** in distributions

Information and Photo Source: AORN
www.aorn.org

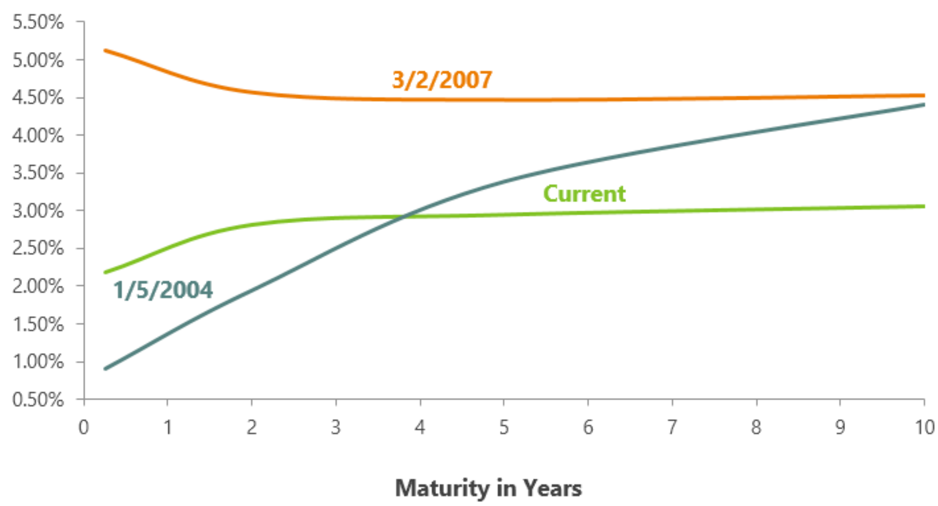
CURVE BALL: IS THE YIELD CURVE SIGNALING THE END OF THE EXPANSION AND THE BULL MARKET? PART 1 OF 2

Scott Middleton, CFA, CIMA®
Principal, Director

For more than nine years the U.S. economy has been in a prolonged period of growth without a recession. Among the 12 economic expansions since World War II, the current one, which started in mid-year 2009, is the second-longest in duration at 111 months (through September 2018). At this stage, it would not be uncommon or unreasonable for investors to ask: "Is the U.S. economy overdue for a recession?"

One of the most closely watched indicators to ascertain where the economy may be headed is the U.S. yield curve. The slope of the Treasury yield curve is normally positive, which means that yields rise from short-term maturities (on the left side of Exhibit A's horizontal axis) to long-term maturities (on the right).

Exhibit A: U.S. Treasury Yield Curves



A normal, or positively sloped, curve (such as on January 5, 2004) indicates that economic growth and inflation are expected to rise in the coming years. Investors ordinarily expect higher yields on Treasuries with longer-dated maturities, especially if the purchasing power of bonds' cash flows are expected to decline over time.

When unemployment falls to low levels and employees' wages begin to increase more rapidly, the Fed has ordinarily raised short-term interest rates (the Fed Funds rate) to fight the threat of rising inflation and an overheating economy (see the March 2, 2007 curve in Exhibit A). Expansions typically end when rising interest rates prompt consumers and businesses pull back on excessive spending and borrowing.

> ***"The four most expensive words in the English language are 'this time it's different.'"***
>
> *-John Templeton, founder of the Templeton investment fund family*

The growing expectation of a slowing economy usually leads to long-term yields falling below those of short-term. Investors determine that the Fed has raised rates too far and/or too fast, which will lead to falling inflation, falling interest rates, and an economic pullback. Later, in times of significant economic weakness, the Federal Reserve typically reduces short-term interest rates to make it more affordable to borrow and to stimulate the economy toward full employment.

The Curve and Recessions

The slope of a yield curve is often measured as the yield on 10-year Treasuries minus the yield on three-month Treasury bills. When 10-year yields drop below three-month yields, the curve becomes inverted. As noted in Exhibit B on the next page, recessions (the shaded vertical bands) have tended to be preceded by an inverted yield curve (when the line has dipped below zero).

The past three yield curve inversions were not very precise in forecasting the end of the accompanying economic expansions. The lead times of the inversions to the end of the expansions ranged from 1.4 years (1989-1990) to 2.6 years (1998 – 2000). In 2006-2007, the lead time was 2.0 years, which is also the average of the last three readings.

The Federal Reserve has raised Fed Funds rate by eight times between December 2015 and September 2018 to gradually remove "easy money" and reduce inflationary pressures. The yield curve on September 28, 2018, was relatively flat, with long-term rates slightly higher than short-term rates. While the yield curve has yet to invert during the current economic expansion, its eventual inversion may indicate that the economy is in its later stages, and not necessarily at death's door.

The very small sample size (three economic cycles) should not be construed as highly meaningful when forecasting future cycles.

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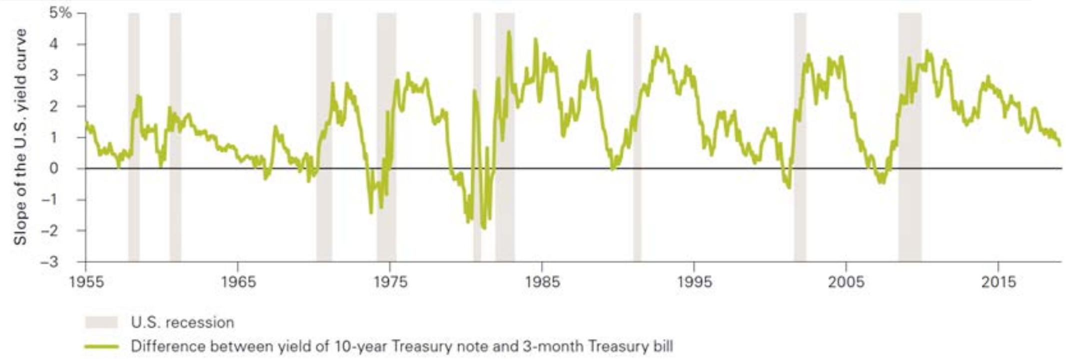
Nonetheless, as seen in Exhibit B, the long-term pattern of inversions before recessions needs cannot be easily dismissed.

Exhibit B: The Slope of the Yield Curve and Recessions



Is This Time Different?

Each economic expansion and accompanying yield curve inversion have both common and unique elements when compared to prior cycles. Some economic prognosticators believe that because of the current cycle's idiosyncratic variables, the yield curve may no longer be a valuable tool when forecasting the next recession. The rationale include:

1. **The yield curve has been heavily distorted by the central banks' manipulation of longer-term yields through quantitative easing (buying intermediate-term bonds and mortgages after the credit crisis to reduce borrowing costs).**
   Nonetheless, banks and other lenders "receive" the interest rates that markets give them, regardless of the reasons behind the numbers. If banks have to pay more for deposits and if loans are therefore not as profitable, lending will begin to dry up. Like very low oil levels in an engine, declining amounts of money for loans can cause the economic engine to seize up (i.e. head into recession).

2. **Because the U.S. economy shows few signs of overheating, inflation expectations are not rising as is common in the late stages of an economic cycle.**
   It's important to recall that economic conditions before each recession are often very positive and are expected to continue. In the late 1990s, some market observers forecasted that the U.S. would never have another recession, in part because the economic expansion had lasted for an unusually long time. Economic excesses are usually seen much more clearly only in hindsight.

3. **The continued global flood of capital into bonds has suppressed longer-term interest rates, artificially distorting the ability of the curve to indicate an oncoming recession.**
   This argument is eerily similar to statements made in March 2006 (less than two years before the start of the worst recession in more than 70 years) by then-Fed-chairman Ben Bernanke. He commented that he "would not interpret the currently very flat yield curve as indicating a significant economic slowdown to come." Bernanke then noted: "This time, both short- and long-term interest rates–in nominal and real terms–are relatively low by historical standards."

In recent months, notable skeptics regarding the economic significance of the current yield curve cycles have included chief economic advisor at Allianz, Mohamed El-Erian, global chief investment strategist at BlackRock, Richard Turnill, and, once again, Ben Bernanke. Current Fed Chair Jerome Powell, however, recently showed some respect for the impact of an inverted curve. In his July 2018 testimony before the U.S. Senate Banking Committee, Powell commented: "If you raise short-term rates higher than long-term rates then maybe your policy is tighter than you think." It remains to be seen whether the actions of the Fed's Open Market Committee will be impacted by an assessment of the yield curve and if a recession can be delayed by postponing another inversion.

Summary

Investors should avoid placing too much weight on the differences between the current economy and prior cycles. Oversubscribing to the newest theories and attempting to outsmart the markets are rarely beneficial strategies. Until proven otherwise, yield curve inversions are of significant economic importance. However, neither should investors construe inversions as precise economic signals.

It seems reasonable to expect that the yield curve will eventually invert, perhaps in the next couple of years. What should investors do when that happens? The relationship between yield curve inversions and the stock market will be the subject of the second part of this article which will appear in the winter edition.

Acknowledgements: The author's appreciation goes to Kenny Senour, Senior Analyst, and Brooks Urich, Analyst Assistant, for their research contributions to this article.

AROUND THE FIRM

RECENT EVENTS

Innovest is proud to welcome four new employees to our team – Paul Nacario, Chuck Sklader, Jordan Rice and Brooks Urich. Paul is a vice president for Innovest and has 28 years of experience in the defined contribution retirement and Registered Investment Advisor (RIA) marketplaces. He offers a unique perspective on the complexities of retirement plans as well as the high net worth RIA segments. For the last 17 years, Chuck has provided consulting services to more than 40 plans with the vast majority being governmental entities. Chuck will be our Arizona service manager. Senior Analyst Jordan Rice will assist Innovest's retirement plan efforts including RFPs, evaluating and benchmarking plans and their service providers, as well as building performance reports and performing asset allocation studies. Lastly, Brooks joins Innovest as an analyst assistant. He will work with the Due Diligence Group and Capital Markets Group to source investment managers, monitor and recommended products and strategies, and evaluate current and future markets.

Additionally, two college interns joined Innovest for the fall semester. Claire Coughlin is entering her final semester at Regis University as an economics candidate. Of note, Claire was the co-organizer of and presenter at the Business School's first annual symposium on ending global poverty. Kathryn Armstrong is pursuing a Bachelor of Arts in business finance at Colorado Christian University. She has traveled to 14 countries for mission work.

Innovest was honored to be named the Top Company in Financial Services in Colorado by *ColoradoBiz* magazine. President Wendy Dominguez was interviewed for the *Denver Business Journal's,* "Table of Experts: Women Leading the Way." CEO Richard Todd was interviewed for the *Real Assets Adviser* article "Roundtable: What Will it Take to Attract the Next Generation of Advisers to the Private Wealth Business." Vice President Sloan Smith's article, "Cryptocurrencies: A Role in Client Portfolios?" was published by *Family Office Elite.*

In September Innovest employees volunteered at Food Bank of the Rockies. Employees spent the day assembling 747 boxes of food totaling more than 21,000 pounds and working in the warehouse to assemble and deliver orders. Also, in July employees delivered meals for Project Angel Heart.

Photos: (Top) Innovest employees volunteer at Food Bank of the Rockies. (Bottom) Employees deliver meals for Project Angel Heart.

Innovest employees attended and spoke at a number of events and conferences this summer.

- Principal Scott Middleton and Vice President Jared Martin spoke at the annual Colorado Public Plan Coalition (CPPC) Conference.
- Vice President Paul Nacario attended the Government Finance Officers Association of Arizona in Tucson, AZ.
- Innovest President Wendy Dominguez moderated two panels at the National Association of Government Defined Contribution Administrators (NAGDCA) annual Conference.
- President Wendy Dominguez spoke at Colorado State University's College of Business's inaugural women in finance speaker series.
- Vice President Marianne Marvez spoke on Intergenerational Communication at the Center for Nonprofit Excellence's annual conference.
- Principal Scott Middleton and Vice President Christian O'Dwyer spoke about the outlook for the economy and financial markets at a BKD event.

On December 13, Innovest will partner with EKS&H (now part of Plante Moran) to host the Rocky Mountain Benefits Plans Conference. The conference features speakers from several companies including Innovest, EKS&H (now part of Plante Moran) and Alvarez & Marsal. CPE credits are available. The cost is $100 per person for the all-day event. For information please contact Whitney Wilkinson at wwilkinson@innovestinc.com, or 303-694-1900 extension 331.

EMPLOYEE SPOTLIGHT

ABIGAIL THOMAS - LEAD SENIOR ANALYST

Abigail is a lead senior analyst at Innovest and a member of the Retirement Plan Practice Group. Abigail helps manage processes and assists in Innovest's retirement plan efforts including completing Request for Proposals (RFPs) for clients, evaluating and benchmarking plans and service providers.

WHERE IS YOUR HOMETOWN?

I grew up in Colorado Springs, Colorado.

TELL US SOMETHING UNIQUE ABOUT YOU.

It's difficult to pick just one. I studied in Vilnius, Lithuania, for half a year. Also, I play/have played four instruments: the bassoon, the baritone, the piano, the vibraphone, and the marimba.

WHAT DO YOU LIKE BEST ABOUT WORKING AT INNOVEST?

My colleagues! I like that I work with people who are genuine, kind and selfless. I am incredibly thankful that I work with people who are smarter than me. My coworkers push me to continuously learn and challenge me to be better than I was yesterday.

HOW DO YOU GIVE BACK TO THE COMMUNITY?

I regularly participate in the Innovest service events with my awesome coworkers. I also volunteer my time as a percussion instructor for a youth performing arts ensemble in Colorado Springs. I am blessed to coach young musicians and watch them mature into smart and confident performers.

WHAT ARE YOUR HOBBIES AND INTERESTS?

I also teach percussion at Littleton High School, and I enjoy writing and arranging music for the ensembles I teach. I like true crime, baking (and eating) and watching the Rockies win. My two cats simultaneously keep me company and destroy everything I own.

TELL US ABOUT YOUR FAMILY.

I have two brothers, one older and one younger. They each are following in my parents' footsteps: my older brother and my dad are both journalists, and my younger brother is studying to be a music director, like my mom. My boyfriend, Evan, is currently earning his masters in trombone performance at the University of Utah - go Utes!

EDITORS

Whitney Wilkinson and Becca Ellis

INNOVEST

RETIREMENT

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