Accounting for Float Income in Retirement Plans

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Understanding Float Income

As individuals plan for their retirement, they often focus on traditional investment vehicles such as stocks, bonds and mutual funds. However, another aspect of retirement planning that is gaining attention is float income. Float income refers to the interest or returns earned by financial institutions on funds temporarily held before they are paid out. This concept has significant implications for retirement plans and can potentially play a role in enhancing overall returns.

What Generates Float Income?

Float income primarily arises from the time lag between receiving funds and disbursing them. In the context of retirement plans, this typically involves the period between contributions made by plan participants and the time those funds are invested or distributed. During this interim period, the funds are often held in cash or cash-equivalent accounts by the plan administrator, custodian or recordkeeper.

Financial institutions can generate income from these idle funds through short-term investments like money market funds, short-term bonds or even interest-bearing checking accounts. The income generated from these investments forms the float income.

Though float income can be a natural byproduct of everyday business processes, the rapid increase in interest rates has increased the amount earned over the past few years, drawing regulatory scrutiny on float income and even resulting in litigation against Plan Sponsors and as a violation of their fiduciary duties under ERISA.

Potential Benefits for Retirement Plans

Float income plays several roles in retirement plans:

1. **Enhanced Return Potential:** By generating additional income from float, retirement plan custodians can enhance the overall returns of the plan. This can potentially translate into higher account balances for participants over time.

2. **Cost Offset**: Float income can also be used by plan administrators and recordkeepers to offset operational costs associated with managing the retirement plan. This may help in keeping fees lower for participants, thereby preserving more of their investment returns.
3. **Risk Mitigation**: The ability to earn float income can act as a buffer against market volatility or unexpected withdrawals. It provides a stable source of income that can help provide support to the operational needs of the retirement plan.

Considerations and Criticisms

While float income can benefit retirement plans, there are considerations and criticisms to be aware of:

- **Transparency**: Some critics argue that the process of generating float income should be transparent to plan participants. Clear disclosure of how float income is used and accounted for is essential for maintaining transparency and helping Plan Sponsors address their fiduciary responsibilities.
- **Regulatory Oversight**: Regulatory bodies often oversee how retirement plan funds are managed, including any income generated from float. Compliance with regulations ensures that float income is managed responsibly and in the best interest of plan participants.
- **Ethical Concerns**: There are ethical considerations regarding the use of participant funds to generate income without direct benefit to the participants themselves. This issue underscores the importance of ethical guidelines and fiduciary responsibilities in managing retirement plans.

Disclosure and Governance Considerations

Under ERISA, retirement plan fiduciaries have a responsibility to ensure that the services provided to their plans are necessary and that the cost of those services is reasonable. Similar to fund expenses and recordkeeping costs, float income represents potential additional compensation to retirement plan recordkeepers, and as such should be documented by plan fiduciaries.

Float income represents a lesser-known aspect of retirement plan management that can contribute to overall returns and operational efficiency. While it offers potential benefits such as enhanced returns and cost offsets, it also requires careful consideration of transparency, regulatory compliance and ethical standards. As retirement planning continues to evolve, understanding how Plan Sponsors manage float income can empower individuals to make informed decisions about their financial futures.

For more information on considerations for fiduciaries relative to float income please contact us to reach one of the defined contribution consultants at Fiducient Advisors.

About the Author

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Greg services institutional clients by providing counsel and guidance on portfolio design, asset allocation, manager selection, investment policy statements and performance monitoring. He is also a member of the Recordkeeper Oversight Council. Greg joined Fiduciary Investment Advisors, LLC in 2017, which combined with Fiducient Advisors in 2020.

Before joining the firm, Greg worked in both institutional and individual wealth management helping create positive retirement outcomes for plan sponsors and plan participants. He received his BA from the University of Connecticut and is a ChFC® (Chartered Financial Consultant). He volunteers as a Chair of the Board for MARCH, Inc. of Manchester, a Connecticut organization dedicated to enriching the lives of individuals with intellectual and developmental disabilities, as a Board Member of the Connecticut Council on Problem Gambling, and as a Board Member for Riverfront Recapture. Greg enjoys biking, hiking, kayaking, running, lacrosse and football in his free time.