Willis Towers Watson

Nine actions for defined contribution plans in 2019

The role of defined contribution (DC) retirement plans has evolved in recent years. Instead of a vehicle that allows employees to save their own money to supplement a monthly employer-provided pension, DC plans are now the sole source of retirement income in addition to Social Security for millions of workers. With the shift to a more DC-centric world, old plan risks have grown and new plan risks have emerged. Importantly, these risks are borne by both plan sponsor and participant, as retirement is generally accepted as a shared responsibility.

In this paper we have identified nine key DC plan risks, and we highlight some of the actions sponsors and participants can take to help mitigate them.

Risks to sponsors

1 Workforce risk

Defined broadly, workforce risk considers the management of employees joining, progressing through and leaving an organization. According to the 2017 Willis Towers Watson Global Benefits Attitudes Survey, about half of those age 50 and older plan to continue to work past typical retirement age. But it's not about working longer: It's about who is being forced to work longer. Employees who want to retire but are not financially prepared can create the risk of a disengaged workforce and contribute to blocked career paths.

Solution

With targeted analytics, sponsors can construct a baseline assessment of their plans with views of the population on age, occupation, location and financial stress to identify individuals or groups that might not be adequately prepared. Armed with well-informed and actionable insights, sponsors can develop an effective plan strategy that fosters retirement readiness.

2 Litigation risk

Despite the shift to a more DC-centric world, investment governance structures and processes have been slow to adapt. Fiduciaries of DC plans have become targets for frequent litigation, specifically in the areas of investment offerings, plan-related participant fees and company stock.

Solution

Plan sponsors should review the structure of their fiduciary committees, and the committees need to update and follow internal governance policies for evaluating investment lineups, reviewing fees and executing best practices to document their decisions. Strong governance also relies on outside experts such as ERISA attorneys and consultants for guidance on evolving regulations in an effort to minimize litigation risk.

3 Talent risk

In organizations where the DC plan has taken over as the primary retirement vehicle for newly hired employees, it is increasingly important that the DC plan aligns with the company's overarching Total Rewards strategy. As the war for talent in today's tightening labor market intensifies, employers need to ensure that the plan design, investment structure, expenses and administration remain competitive to help attract and retain key talent.

Solution

Regular plan design benchmarking from a Total Rewards perspective is essential to ensure your plan not only is competitive but also meets the evolving needs of your workforce. Willis Towers Watson research shows that key areas of focus among employers who have recently made benefit changes include: a) improving personalized communication, b) enhancing technology to administer benefits, and c) promoting employee wellbeing. In addition, DC plan design should consider other elements of Total Rewards, such as stock compensation, that serve capital accumulation objectives and are not available to all

employees. The incremental expense that accompanies changes in plan design can be significant, so it's critical that a sponsor carefully considers the financial impact to ensure that the plan continues to support organizational goals and business priorities.

Distraction risk

To adequately address the evolution of DC plans as a key workforce management tool, committees must evaluate their priorities and how they spend their time rather than simply taking on more responsibilities. The average committee member can dedicate only about 5% of his or her time to plan management issues.[1] We believe that is not enough time for even the most basic review of a DC plan, its operations and its results.

Solution

As DC plans have grown in size, importance and sophistication, the level of investment-related governance required to manage a DC plan has increased. Consequently, we believe sponsors should adopt one of two strategies to allow their committees to refocus their efforts on improving retirement outcomes: either delegate investment decisions to an internal subcommittee or delegate them to an outsourced chief investment officer (OCIO).

Compliance risk

Today's DC plan sponsors face an increasingly complex regulatory environment, and with this comes additional fiduciary exposure. Many sponsors rely on outsourced experts for plan documents, administration, recordkeeping and more – making holistic plan management difficult. Business activities such as M&A, new IT systems or department restructuring modify processes and procedures, which can result in unintended consequences to plan operations.

Solution

Operational assessments, compliance reviews, governance evaluations and payroll reviews – led by seasoned experts – can help mitigate risk and increase efficiencies in plan management. Both one-time and ongoing reviews are key drivers of long-term success and can save sponsors from IRS and Department of Labor penalties, unnecessary vendor expenses and negative publicity.

Risks to participants

Investment risk

One of the biggest impacts of DC plans taking on the role of primary retirement vehicle is the shift of investment risks from the plan sponsor to the participant. This is certainly a benefit when viewed from the employer's lens, but it creates significant challenges for many individuals who are now tasked with making complex investment decisions in order to ensure their own retirement adequacy. This risk is particularly concerning when you consider how many workers today lack even a basic level of financial literacy.

According to a 2018 research paper,[2] a major concern with DC plans today is the volatility of the underlying accounts, which are invested primarily in a mix of only stocks, bonds and cash. As an example, the research considers a worker ready to retire in early 2008 with a typical mix of 50% equities and 50% bonds. Given market volatility from January 2008 to March 2009, this worker, who was nearing retirement and thought she was invested appropriately, would have lost over 18% of her balance and significantly impaired her retirement adequacy. With access to a more diversified asset mix, she could have better protected herself from risk as she neared retirement.

Solution

DC plans have traditionally provided their participants with a long list of options with emphasis on equity style boxes. However, committees should focus on simplifying investment decisions for participants by streamlining the menu with professionally managed portfolios that consider the fundamentals of portfolio construction, such as diversification of return drivers and downside risk.

This also calls for committees to reevaluate Qualified Default Investment Alternatives and consider the benefits of custom target-date funds (TDFs) rather than simply following the herd to low-cost, passively managed options. Asset classes such as private equity, real estate and hedge funds can be used to create a "diversified TDF" that improves retirement outcomes by diversifying the investment portfolio with alternative asset classes and improving returns when compared with a portfolio solely composed of equities and fixed income.

[1] Willis Towers Watson, "Improving retirement readiness: Start with defined contribution plan governance," April 2018

[2] Georgetown University Center for Retirement Initiatives, "The Evolution of target date funds: Using alternatives to improve retirement plan outcomes," June 2018

7 Savings risk

We know that inadequate savings rates within DC plans are the biggest hurdle to retirement adequacy among today's workers. Unfortunately, many workers lack a clear understanding of how much to save or are unable to make informed decisions when confronted with competing financial priorities.

Solution

Re-enrollment sweeps, auto-escalation and segmented employee communications can help. Willis Towers Watson research shows that employees increasingly favor broad financial modeling tools that address a range of financial issues, provide coaching, show trade-offs, deliver simple personalized messages and address complexities behind the scenes. Sponsors can also consider modifications to program design that can support employee wellbeing, from support for employees paying down student debt to altering the design of the employer contribution.

8 Tax risk

A more strategic risk for participants involves *tax optimization* – potentially lost savings from not taking advantage of Roth 401(k) and IRA accounts, or the triple tax savings of contributing to tax-advantaged health savings accounts (HSAs).

Solution

In addition to redoubling efforts on educating participants on the long-run value of alternative tax strategies, as well as comprehensive financial wellness tools, committees should consider adopting default options into Roth structures or promoting the use of HSAs to cover medical expenses or provide income during retirement.

9 Longevity risk

Employees haven't adjusted their "ideal" retirement age, despite a significant increase in life expectancy. This is good news for workers who can look forward to an even longer retirement, but with the shift toward DC plans, many retirees face the risk of outliving their savings.

Solution

While savers have long had access to annuities and other insurance-based solutions in the retail marketplace, the products are often complex, opaque and expensive. Plan sponsors and their committees should follow a rigorous, documented process to carry out their due diligence. The optimal approach might include a combination of solutions, including annuities, account drawdown tactics and Social Security claiming strategies.

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