Corner Office Views

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Corner Office Views

Timely Insights to Inform your Business Strategy

Lead with knowledge and perspective. Connect with secular trends impacting financial services, interpret what they mean for your business, and drive new opportunities. Cerulli's Corner Office Views provides market-leading insights and tangible takeaways for senior executives seeking to strengthen and scale their business models.

About the Author

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Prior to joining Cerulli Associates, Shawn worked as a Research Associate at Harvard Business School, where he co-authored case studies on investment management for professional and personal investors and managing and innovating in financial services. Prior to that, he worked in the Currency Management group at State Street Global Markets, employing currency overlay strategies for large asset managers and asset owners.

Education

- Boston College
  Master of Science in Applied Economics
- Merrimack College
  Bachelor of Science in Finance
- CFA® charterholder

Honors and Awards

- Quoted in the *Financial Times, Barron's, Pensions & Investments, FundFire*, and other industry leading publications as a subject matter expert on the U.S. retirement market

Can Defined Contribution Plans in the U.S. Support Decumulation?

Communication with plan sponsors is critical

Key Points

- Defined contribution (DC) plans are not typically designed to effectively support participants through their retirement years.
- Some plan sponsors are implementing, or strongly considering, plan design changes necessary to make their plans more effective decumulation vehicles.
- Plan fiduciaries looking to make their DC plans more retiree-friendly will likely turn to recordkeepers, asset managers, and other providers to help them create a retirement tier or execute on other decumulation-focused plan design changes.

Lacking decumulation features

Many of today's DC plans lack the plan design features (*e.g.*, low-cost, flexible withdrawal options, a comprehensive investment opportunity set) necessary to support participants through the decumulation phase of their retirement lives. Rather, as retirement comes into focus, many DC participants engage a financial advisor who may encourage them to roll their DC assets into an IRA as part of a financial planning or wealth management relationship. However, many plan fiduciaries and providers are acutely aware of the potential benefits—to both plan sponsors and participants—of keeping DC assets in plan during retirement and some plan sponsors exhibit a strong interest in making their DC plans more effective vehicles for asset decumulation.

The largest plan sponsors, who are more likely to view their retirement plan as a tool for attracting and retaining employees, tend to be the earliest adopters of more innovative, paternalistic trends within the DC space. Larger plan sponsors (with more than $500 million in plan assets) exhibit a relatively strong interest in retaining retired participant assets and are likely more interested in making their DC plans more effective decumulation vehicles. By way of example, in April 2021, Lockheed Martin—one of the largest 401(k) plan sponsors in the country—began restructuring its DC plans, striving to make its 401(k) plan more retiree-friendly and actively encouraging participants to keep their assets in plan during retirement.

Retirement tiers

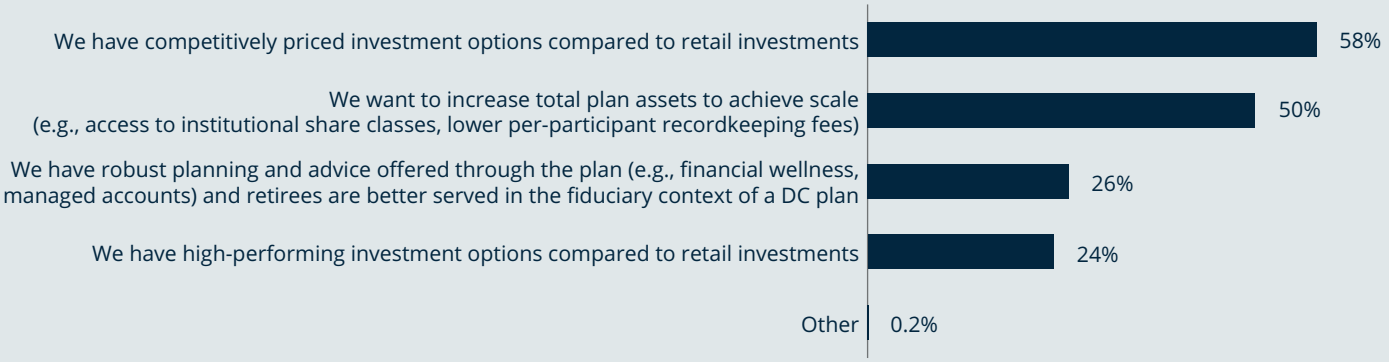
Within the context of retiree-friendly DC plans, several recordkeepers and asset managers note that some of their largest DC plan sponsors are implementing retirement tiers or are strongly considering one, turning to their investment consultant partners for guidance around strategy and implementation. The Defined Contribution Institutional Investment Association (DCIIA) defines a retirement tier as "a range of products, solutions, tools, and services all of which allow a DC plan sponsor to broaden the plan's goal from one wholly focused on savings to one that also accommodates and supports participants who are near, entering, or in retirement."

> Retirement tiers are still a relatively novel concept within the DC space.

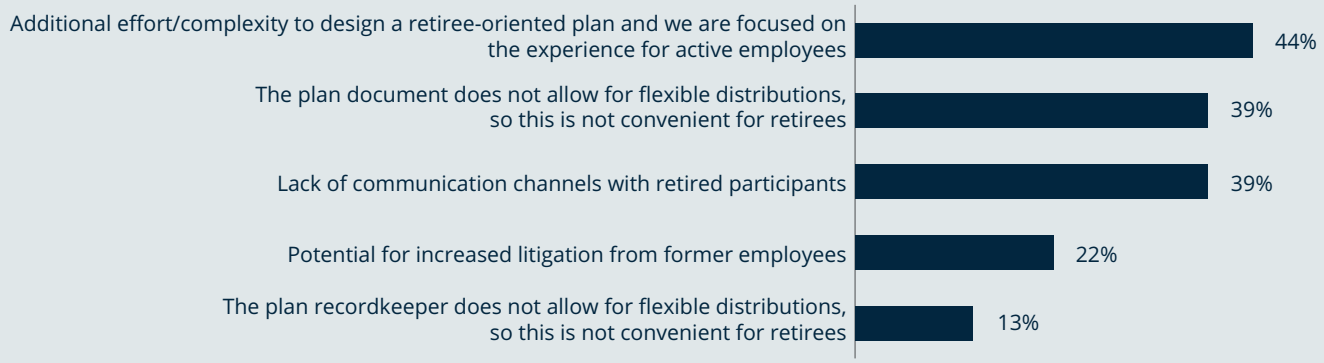
Retirement tiers are still a relatively novel concept within the DC space, but, according to a 2021 survey of institutional investment consultants conducted by PIMCO, the top priority for "leading edge" DC plan sponsor clients (i.e., plan sponsors that are early adopters of innovative products and services) was evaluating retirement income, followed by setting up a retirement tier. Further, Cerulli finds nearly three-quarters of defined contribution investment-only (DCIO) asset managers indicate retirement tiers will become more widespread in the near term. For plan sponsors, perhaps the most notable benefit to retaining retiree assets is increased scale; with a larger plan asset pool, plan fiduciaries can potentially negotiate more favorable pricing arrangements with asset managers, recordkeepers, and other providers.

401(k) Plan Sponsors: Views on Retaining Retired Participants' Assets, 2020

Reason for Preferring Retirees Stay In Plan

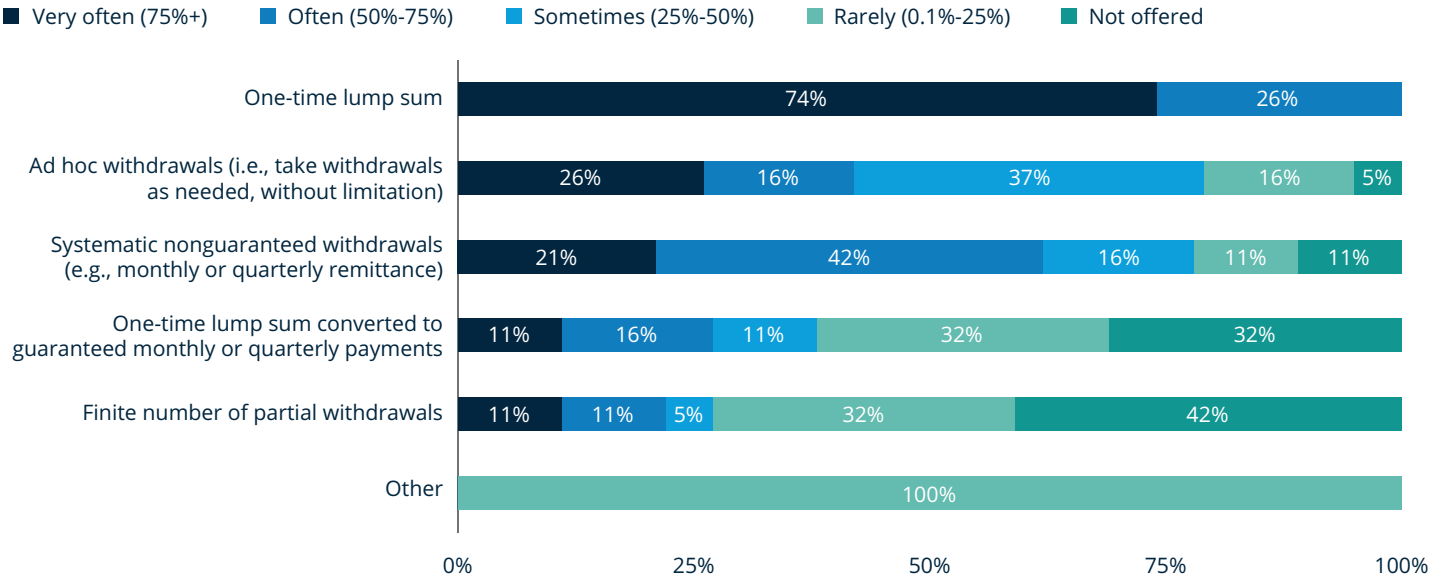


Reason for Preferring Retirees Withdraw Assets



Source: Cerulli Associates | Analyst Note: 1) In the previous exhibit, respondents were asked, "When 401(k) participants separate from employment or retire, which of the following distribution options does your company prefer they take?" 2) Respondents who selected "Keep assets in our company's 401(k) plan" in the context of retirees were asked to specify why. "Other" includes "better employee experience."3) Respondents who did NOT select "Keep assets in our company's 401(k) plan" in the context of retirees were asked to specify why they prefer for retirees to leave the plan.

DC Recordkeepers: Distribution and Retirement Income Options Offered to Separated Participants, 2020



Sources: Cerulli Associates, in partnership with The SPARK Institute and DCIIA | Analyst Note: Respondents were asked to specify the percentage of recordkept plans that offer the following distribution options. "Other" includes "plan exceptions," which are rarely deployed.

Plan design changes

Cerulli asserts the design changes necessary to make DC plans attractive retirement destinations call for coordinated efforts between recordkeepers, consultants, plan sponsors, and asset managers. Retirement tiers and other retiree-friendly plan features should arm participants with the planning tools, personalized advisory services, investment products, and withdrawal options necessary to support participants through their retirement years.

As a start, plan fiduciaries should ensure their plan's documents allow for flexible, inexpensive distributions and a recordkeeping platform that can smoothly facilitate flexible distribution options (*e.g.*, monthly, quarterly, ad hoc, and partial withdrawals). To that point, investors identify flexible distribution options as one of the most important features of a retirement income solution as they are critical to ensuring retirees can adjust their drawdowns in response to lifestyle changes or meet unanticipated expenses as they arise. Cerulli notes larger plan sponsors are more likely to allow for flexible withdrawal options in their plan documents. For instance, a 2021 survey of DC plan sponsors, conducted by Cerulli in partnership with DCIIA, finds 96% of plan sponsors with greater than $5 billion in assets allow for ad hoc withdrawals, compared to 69% for the entire survey population.

Moreover, plan sponsors will need to work with their fiduciary partners, asset managers, and recordkeepers to ensure participants have an investment opportunity set necessary to construct an effective investment and drawdown strategy in retirement. In some cases, this may require a "sidecar" or secondary investment lineup, or expanding the core menu to include a wider variety of corporate and government bond funds, dividend-yielding equities, managed payout funds, insurance-backed products, and other investment products that could be valuable to retirees. In conversations with Cerulli, managed account providers relay some of their larger plan sponsor clients make certain fixed income products available in the managed account that aren't available to the entire participant population.

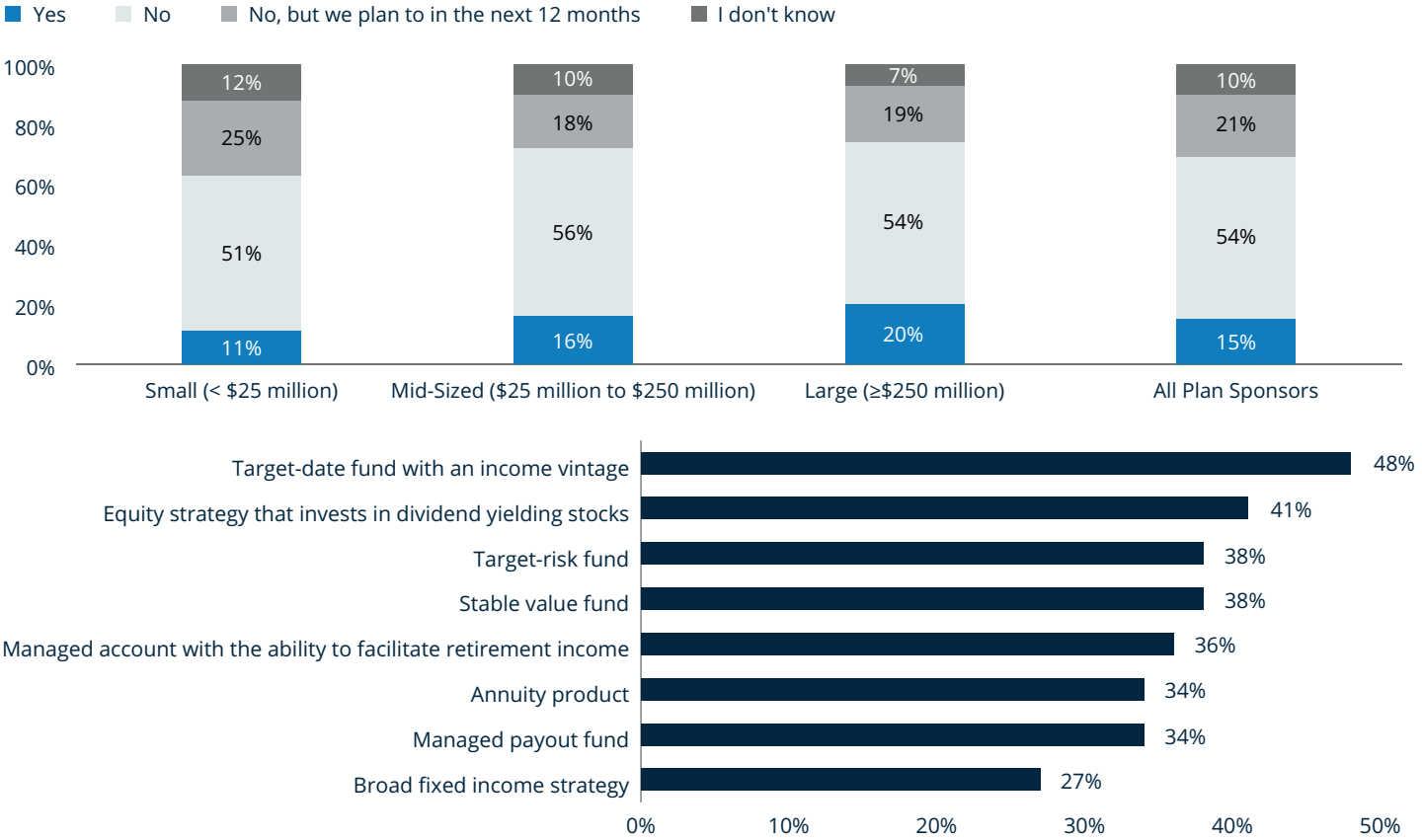
As a start, plan fiduciaries should ensure their plan's documents allow for flexible, inexpensive distributions and a recordkeeping platform that can smoothly facilitate flexible distribution options.

Communication

As plan fiduciaries look to add more retiree-focused investment options to their plan menu, asset managers and insurers should be prepared to communicate the value proposition of their income-oriented investment products and illustrate how these products can help retirees achieve superior financial outcomes in retirement—whether that's by limiting downside risk, enhancing portfolio diversification, or helping them generate a sustainable, predictable stream of income, among other potential benefits. In the near term, Cerulli notes that the largest plan sponsors with more paternalistic benefits philosophies are most likely to consider implementing a retirement tier or other decumulation-focused plan design changes. As such, asset managers offering income-focused products should focus their distribution efforts on large and mega plan sponsors, and their national investment consultant partners.

Plan sponsors will also need to alter and/or augment their participant communications to build awareness of their plan's decumulation features and foster proper utilization. Plan sponsors and providers should begin educating participants on their plan's decumulation-focused features, such as flexible withdrawal options, income-oriented investment products, and in-plan advice options years prior to their anticipated retirement age. Educational engagements and messaging should include the general pros and cons of keeping one's assets in the firm's DC plan during retirement. Within the context of this messaging, providers can highlight digital planning tools that can participants crystalize their retirement readiness. For instance, using a series of inputs (*e.g.*, contribution rate, account balance(s), market conditions, expected retirement age), interactive scenario modelers can help participants translate their DC account balance(s) into a projected stream of income in retirement and assess their expected retirement replacement ratios—arguably more meaningful figures than one's DC account balance.

401(k) Plan Sponsors: Availability of In-Plan Retirement Income Product(s), 2020



Sources: Cerulli Associates | Analyst Note: Only respondents with an in-plan retirement income product were asked to specify the type of product.

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Headquartered in Boston with fully staffed offices in London and Singapore, Cerulli Associates is a global research and consulting firm that provides financial institutions with guidance in strategic positioning and new business development. Our analysts blend industry knowledge, original research, and data analysis to bring perspective to current market conditions and forecasts for future developments.

Cerulli's research product line includes the Cerulli Report series, the Cerulli Edge series, and Cerulli Lodestar.

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