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Employee Benefit Plan Review

Defined Contribution Retirement Plans: Chatting with Josh Anderson

By Katrina L. Berishaj

Ask the Expert columnist Katrina Berishaj discusses trends in defined contribution retirement plans with The Retirement Innov8ion Lab founder Josh Anderson. The conversation has been edited for clarity.

Katrina Berishaj (KB): With the retirement landscape constantly evolving, are you seeing any trends in the defined contribution space?

Josh Anderson (JA): We are seeing many new trends in the retirement plan space, but the three most significant include personalization, in-plan retirement income or guaranteed retirement income, and multiple employer plans or "group plans."

It is becoming increasingly important to be able to deliver more personalized advice to an individual based on their situation and include outside factors not incorporated by a target date fund. For example, personal risk tolerance, savings in an individual retirement account, other retirement plans, pensions and even spousal assets.

There is also an uptick in the adoption of multiple employer plans or "group plans" – for example, PEPs (pooled employer plans), GoPs (group of plans) and MEAPs (multiple employer aggregation plans) – that allow plan sponsors to offload their liability, their day-to-day responsibility and really reduce the burden of running a plan from both a time and fiduciary liability standpoint. Some recordkeepers have reported that up to 80% of their new sales are in these "group plans."

KB: We have seen a lot in the headlines about in-plan guaranteed retirement income options in light of the Setting Every Community Up for Retirement Enhancement (SECURE) Act. What are plans thinking as far as guaranteed retirement income options are concerned?

JA: We are certainly seeing a lot of interest in that space, and for good reason. The number of Americans on track for retirement is nowhere near where it needs to be, and it is catching the eye of influential people. Notably, BlackRock Chairman and Chief Executive Officer Larry Fink wrote about it in his annual shareholder letter.[1] He captured it very well – there is a huge need for improved retirement outcomes and for more innovative plan solutions to be offered using the building blocks we have today.

The reality is that people are living longer. With advancements in biotech and personalized medicine, people are living much longer than they were in the past. It is something that we are seeing globally and brings into question how people will fund retirement in the future. Will the traditional three-legged stool approach of personal savings, employer-sponsored savings and government-funded savings (for instance, Social Security) be adequate to support longer and healthier lives? These programs were set up at a time, especially Social Security, when life spans were much shorter.

Today, we need to rethink how retirement plans are designed and delivered. We are seeing people adapt to greater life expectancy by working longer, which has an impact on profitability and workforce planning. For younger workers, it becomes harder to move up and advance within a company, which can lead them to become disenfranchised. Last year, about one-third of companies reported challenges with promoting younger workers due to older workers delaying retirement.

We saw the number of workers delaying retirement double in 2022. If you are an executive or have a stake in the profitability of the company – this can often be an overlooked cost with a huge impact. For instance, a 2019 Prudential survey[2] pegs that incremental cost for an employee who delays retirement past 65 at $50,000 per employee. If you were to assume that about 6% of the total workforce is above 65, taking a 75-person company and applying the average, approximately five employees are delaying retirement; this equals roughly $250,000 in additional cost. This can certainly add up and negatively impact the bottom line. It also affects the cost of health insurance, with a recent study[3] indicating that 35% of companies reported that delayed retirement has made their health insurance more expensive.

Beyond employee satisfaction and helping provide workers with the ability to attain a dignified retirement on their own terms, the financial impacts on the business are often a key factor in deciding to add an in-plan guaranteed income solution to their plan. Recent legislation has aided this, and we see increasing interest in the SECURE Act safe harbor, effectively making it easier for plans to adopt in-plan guaranteed retirement income options.

KB: What types of retirement income solutions are defined contribution plans looking for with respect to driving better participant outcomes? Are there any obstacles to the adoption of these products or services?

JA: There are certainly a few considerations. Two initial challenges were portability and availability. Participants need to be able to keep the annuity benefits they accrued when they changed jobs, and the products themselves need to be made available on the platform. This had been a challenge due to the large technology build required by the recordkeepers.

However, starting in late 2023 and early 2024, we have begun to see these products go live with a handful of recordkeepers.

Now that plans have access to the products, we still face several challenges. One is that the SECURE Act offers a safe harbor, but it is narrow. It protects the fiduciary on the solvency of the insurer in the future. However, it does not provide protection on the due diligence process used to select the right product based on the plan's needs and demographics, and that is an area where we are starting to see more service providers come to market with solutions to fill that gap. One example is Nestimate, a financial analytics company focused on providing due diligence tools to help determine which in-plan annuity is right for your plan. They are unique in that they factor demographics and plan preferences as a major input in determining what's right for your plan.

The other is fiduciary risk. With the decision to offer these products comes fiduciary risk, and there are challenges to analyzing in-plan annuities versus investments like mutual funds. Historically, the industry has had a number of educational programs or services and a fairly standardized way of analyzing investments. However, most advisers are not experts in due diligence on annuities to be offered within a plan. They may be familiar with retail annuities, but institutional annuities coming into the 401(k) space are much different than retail annuities. There is going to be a learning curve for advisers and the broader industry to become a "prudent expert" in order to give advice and select the right solution for a 401(k) plan, which the Employee Retirement Income Security Act (ERISA) requires.

There is also the challenge of benchmarking and analyzing the delivery method. Typically, an in-plan annuity will be combined with either a target date or a managed account. Sometimes, an in-plan annuity may be offered as a stand-alone option, but that is likely the exception rather than the rule. There are a wide variety of types and structures. Some are geared more toward solving for income at the time of retirement; some may have an accumulation attribute to them and grow via an underlying fund or index, while others may grow at a fixed rate. This adds a layer of required due diligence in selecting the right delivery method in analyzing a target date or managed account program and determining how those services incorporate the annuity design.

For instance, how does it change fees? How does it impact the glide path in a target date fund or asset allocation models within a managed account? These are complex decisions that carry fiduciary risk, and we typically see plans engage an outside expert to help them make a decision.

Notes

1. https://www.blackrock.com/corporate/investor-relations/larry-fink-annual-chairmans-letter.
2. https://www.prudential.com/employers/group-insurance/industry-insights.
3. https://news.nationwide.com/download/1245328/nationwideinplansurvey-2022pnm-19694ao.pdf.

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