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RETIREMENT**SOLUTIONS**

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IS IT TIME TO REASSESS DC FIXED INCOME OPTIONS?

Current choices may not effectively serve pre- and post-retirees.

Over the past decade, Defined Contribution plan menus have gone through a dramatic transition. For the most part, gone are the laundry list menus that resulted in participant confusion. Sponsors are now more thoughtful about what investments should be included and many try to direct participants to the options that best fit the level to which participants want to engage in managing their portfolios.

However, many DC menus are still built for long-term accumulators. Today, DC plans average around 18 investment options, but only a few of these represent fixed income. In many cases, plans offer only two—money market and core bond—leaving participants at or near retirement with limited choices for building a capital preservation-oriented portfolio. These participants may look to fixed income options to lessen portfolio volatility as they move away from equities. For plan sponsors that wish to keep participants in a plan after retirement or have a large participant base over the age of 55, it may be time to take a deeper look at the fixed income options they provide.

Changing the Menu

DC sponsors may wish to consider adjusting their plan menus in a number of ways.

If the current fixed income plan menu consists of just a core bond fund along with a money market or stable value option, they may wish to consider replacing the core strategy with something more flexible, such as a core-plus fund or multisector bond fund. Such funds have the ability to invest in a broader range of assets and typically have more leeway in adjusting duration or credit exposures. Given currently low yields and the potential for tighter monetary policy and higher rates down the road, core-plus or multisector bond may be a more attractive choice.

Plans may also want to consider adding *more* fixed income investment options. Research has shown that older participants with higher incomes and longer job tenure hold more funds in their accounts.[1] A broader range of choices should empower participants who wish to build their own portfolios. Possible options might include a multisector bond fund, a high yield fund and an emerging market debt fund in addition to the existing core or core-plus bond fund and money market or stable value option.

Another idea for plan sponsors to explore in relation to older participants is to offer a fund designed to hedge against inflation. These funds typically have the ability to broaden portfolio diversification while helping to manage the damaging effects that inflation can have on participants' portfolios.

[1] "The Inattentive Participant: Portfolio Trading Behavior in 401(k) Plans", University of Michigan Retirement Research Center, 2006.

Finally, plan sponsors that offer a passively managed core bond fund may want to reevaluate the decision and consider whether an active approach might be more appealing in the current market. Most broad indices today are heavily weighted toward Treasuries and other government securities and thus provide little yield to buffer potentially higher interest rates. Active managers may have greater flexibility to manage this risk.

Right Mix to Achieve Goals

Every plan is different and participant cohorts can have very different needs and goals, so there is no one-size-fits-all approach. In our view, an important focus should be on designing the fixed income portion of a DC plan menu so that participants, whether accumulators or harvesters, can build portfolios for a comfortable retirement. Having the right fixed income investment options in place may be critical in providing the tools to help them achieve their goals.

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