The Retirement Tier

A GUIDE FOR PLAN FIDUCIARIES

NEUBERGER | BERMAN

We are in a time of greater longevity, with defined contribution (DC) plans increasingly serving as the nation's primary retirement savings vehicle. As a result, plan participants often are looking for investment solutions that help them generate income and preserve assets as they approach or enter retirement. For their part, plan sponsors face the challenge of evolving their plans to help participants meet these crucial needs.

DC plans have historically focused on the accumulation phase of a participant's life cycle. In theory, participants make contributions, often benefiting from an employer match, and gradually capitalize on appreciation potential to build a nest egg expected to last through retirement. However, when the time to retire comes, many participants worry about turning savings into retirement income. As DC plans seek to adapt to the needs of participants near and in retirement, we believe the development of a "Retirement Tier" of investment services can be an effective solution, providing key advantages to both sponsors and retired participants.

To help plan sponsors evaluate how to address the needs of participants nearing retirement, this guide:

- Provides an overview of the current landscape of DC plans in relation to retirement concerns
- Explains the potential benefits for both retirees and plan sponsors in keeping assets in the plan
- Outlines approaches for incorporating a Retirement Tier into retirement plans

FROM SAVING TO SPENDING

DC plans were originally designed as supplemental savings vehicles focused solely on the accumulation phase of the participant life cycle. Investment choices were typically geared toward growth, with a few token income funds provided for diversification. When participants retired, they would roll over savings from employer plans into an IRA or other vehicle, with distributions usually taking place outside the plan.

Today, as DC plans are becoming the primary savings vehicle and participants are becoming increasingly concerned about their retirement preparedness, it is of growing importance that plans are oriented to address the needs of participants near or in retirement.

63%
of 401(k) plan assets are held by participants in their 50s or 60s.[3] As they approach retirement, participants are more likely to engage with their asset allocation.

A SEISMIC SHIFT IS OCCURRING

- 83% of baby boomers are saving for retirement in a 401(k) or similar plan, and/or outside the workplace.[1]
- On average, 10,000 baby boomers reach the average retirement age every day in the U.S.[2]

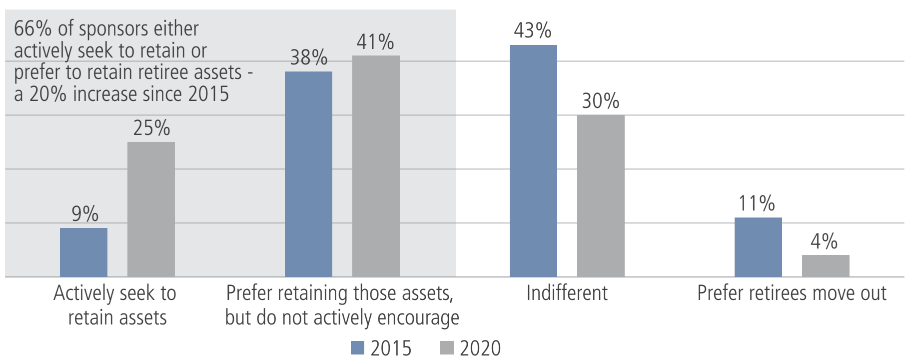
As participants seek help with their retirement income challenge, they are looking to plan sponsors for answers. Yet today, many plans lack the appropriate plan design, investment options and necessary planning tools to effectively transition participants from saving to spending their savings in and through retirement.

KEEPING PARTICIPANTS IN THE PLAN AFTER RETIREMENT IS IMPORTANT TO MANY PLANS

As illustrated in chart below, DC plans are experiencing outflows as retirees liquidate assets from their employer plans.

Not surprisingly, many plan sponsors are becoming highly focused on the departures of retirees. More than 60% of employers want to keep retirees in their plan.[4] Adding solutions for nearing and current retirees may help plan sponsors retain this valuable participant group.

PLAN SPONSORS ARE INCREASINGLY FOCUSED ON RETAINING ASSETS IN-PLAN



Source: PIMCO Defined Contribution Consulting Support and Trends Survey April 2015, June 2020.

We believe the development of a Retirement Tier of investment services can serve as an effective solution in dealing with these concerns.

401(k) Plan Participant Perspective: Intentions for 401(k) Account Savings at Retirement*

* Source: The Cerulli Report, U.S. Retirement End Investor 2018 - IRA owners and 401(k) plan participants.

POTENTIAL BENEFITS OF KEEPING PARTICIPANTS IN THE PLAN

Incorporating a Retirement Tier into a DC plan could have a number of potential benefits for both retirees and plan sponsors.

VALUE TO RETIRED PARTICIPANTS

- **Lower Costs.** Retirees would likely incur higher fees in an IRA or similar vehicle. The purchasing power of a company retirement plan, with institutionally priced investments, is often significant compared to that of an individual.

- **Fiduciary Oversight.** Participants, regardless of employment status, can benefit from continued fiduciary oversight from a professional investment committee. Without the support of an institutional fiduciary, former participants may struggle to maintain a portfolio that is appropriate for their needs and may lack the knowledge or resources to seek the advice of a financial professional.

- **Simplicity.** Staying in the plan provides the ease of having one holistic source for all their retirement funding, education, tools and advice that are available through the plan.

VALUE TO PLAN SPONSORS

- **Better Pricing.** As more assets stay in the plan, a more advantageous cost structure may result. Increased scale can translate into lower recordkeeping costs and lower investment expense as the plan may be eligible for lower-cost share classes, especially if the retiring participants have the large balances common to older workers.

- **Engaged Employees.** A comprehensive retirement plan can be a valuable part of an employee's overall benefits package. As such, it may be a key source of loyalty to the employer and contribute to responsible decisions about when to retire. Offering post-retirement investment options may help with recruiting and retention, and encourage new employees to roll over balances from other plans.

- **Strong Corporate Culture.** By demonstrating that the plan is invested in the best interest of the participant for the long term, a Retirement Tier may contribute to a stronger overall corporate culture.

EXPLORING THE RETIREMENT TIER

To address the shifting needs and concerns of the retiring workforce, an increasing number of plan sponsors are evaluating the importance of keeping participants invested in their DC plans through retirement. We believe that plan sponsors should consider adding through-retirement options to their plans.

The term Retirement Tier is used to describe a platform of investment products, tools and services designed specifically for plan participants nearing retirement who are interested in remaining invested in their employer-sponsored DC plan. The product solutions and educational resources within the tier are tailored to take into account the specific goals and needs of participants who are transitioning to the spending phase.

Separate from the traditional tiers commonly referred to by DC industry professionals (see tiers 1–3 in the below display), the Retirement Tier is intended to be a complementary feature and refers to a range of retirement-oriented services and investment options rather than a single retirement income solution.

When adding a Retirement Tier, a DC plan menu may consist of the three traditional tiers with an additional collection of core menu options selected specifically for nearing and current retirees.

A RETIREMENT TIER COMPLEMENTS THE TRADITIONAL TIERS

Tier 1 | **Do it for me:**
QDIA
- Target Date Series
- Managed Accounts

Tier 2 | **Do it with me:**
Core Menu
- Domestic Equity
- International Equity
- Fixed Income
- Capital Preservation

Tier 3 | **Do it myself:**
Brokerage Window
- Self-directed (Not used by all plans)

Retirement Tier Menu
- Decumulation Investment Solutions
- Growth Investment Solutions
- Conservative Withdrawal
- Moderate Withdrawal

Educational Tools and Resources

RETIREMENT-FRIENDLY PLANS

As DC plans continue to transition from a supplemental source of income to a primary one, the Defined Contribution Institutional Investment Association (DCIIA) suggests "that plan sponsors evaluate their plans' objectives with respect to retired/separated participants and then determine if the plans' retirement income and distribution options align with these objectives. Plans that seek to encourage plan participation through retirement may want to consider offering retiree-friendly options, including partial withdrawals and periodic payments, as well as products and services designed specifically to provide greater security, stability and sustainability of retirement income."

Source: DCIIA, "Design Matters: Plan Distribution Options," May 2018.

IMPLEMENTING A RETIREMENT TIER

To support participants who are shifting their focus from saving to spending, the tier should include four elements:

1 **Plan Design** that allows for flexible withdrawal options and is structured in a simple, understandable manner.

2 **Investment Solutions** that are targeted to help retirees cover their essential and non-essential expenses. Unlike the saving phase, the spending phase typically requires more predictable returns; plan sponsors should consider offering solutions that target a specific income stream.

3 **Planning Tools** such as budgeting, income and legacy planning resources, and calculators for Social Security optimization, savings gap estimation, health expenses, Medicare coverage, etc.

4 **Targeted Communications** specifically for participants nearing retirement, directing them to educational content and other resources. For example, explaining catch-up contribution options and how to transition their existing investment portfolios.

KEY IMPLEMENTATION CONSIDERATIONS FOR PLAN SPONSORS

In implementing a Retirement Tier, plan sponsors should evaluate their current investment options and consider whether they include strategies suitable for both the accumulation and spending phases. They should consult with recordkeepers and evaluate their current education program to ensure they are well equipped to meet participant needs.

- **Plan Design—Document and Distribution Options**
  - Plan sponsors should consult with their recordkeepers to discuss available options and the ability to facilitate partial (ad hoc) and/or systematic withdrawals, and if necessary, amend plan documents. Sponsors seeking to keep participants in-plan are increasingly realizing that providing a single lump-sum payout is no longer sufficient.
  - Including options such as periodic partial withdrawals, monthly installment payments and other flexible distribution strategies allows retirees to turn their account balances into an income source that is suited for their individual needs.
- **Plan Line-Up and Components**
  - Investment menu options should support common retiree objectives of defending against longevity, market drawdowns and inflation risks. Further, since the goals of retirees can vary greatly, a one-size-fits-all approach such as a target date fund may not be as favorable in the decumulation phase.
  - A selection of investment options well suited to address key retirement challenges bundled into a specific 'Retirement Tier Menu' can help avoid confusion and allocation mistakes.
- **Education Outreach**
  - Plan sponsors should develop a comprehensive retirement transition communication program to educate participants on the benefits of staying in the plan and transitioning their portfolios accordingly.
  - Implementation of a Retirement Tier also presents the opportunity to further educate participants on the benefits of the overall plan. Pre-retirement education can help reduce participant stress regarding how much they will need to replace current income in retirement.
  - Further, well-educated participants that feel confident about how to retire on time may lead to company benefits such as increased productivity, promotion of the younger workforce, and elimination of some of the potential for increased health care costs often associated with an aging employee base.

HOW DO FIDUCIARIES EVALUATE ADDING A RETIREMENT TIER?

The decision to include a Retirement Tier depends on a company's particular circumstances, demographics and the needs of retirees.

Considering that 63% of 401(k) plan assets are held by participants in their 50s or 60s, adding a tier of products and services specific to this cohort is of growing interest.

PLAN DEMOGRAPHICS—WHAT PERCENTAGE OF ASSETS IS HELD WITH EACH COHORT?

Source: EBRI/ICI. 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2018, March 2021.

INVESTMENT PRODUCT CONSIDERATIONS

We believe the addition of a retirement-oriented menu of investment solutions within a DC plan can go a long way in meeting the needs of nearing and current retirees. The goal of a Retirement Tier is to provide tailored investment options that effectively complement the solutions that are currently available in the plan.

WHAT INVESTMENTS COULD WORK FOR A RETIREMENT TIER?

It's important to keep in mind the particular risks faced by nearing and current retirees, such as longevity risk, interest rate risk and the risk of a market drawdown. Toward the end of a career, the need for preservation of assets becomes more essential. In what's known as sequence risk, a sharp decline at the cusp of (or early in) retirement can have devastating consequences as participants may soon need to tap into depleted capital to make ends meet. At the same time, both nearing and current retirees may require some growth potential to offset the impacts of inflation and spending in order to preserve portfolios across today's longer lifespans.

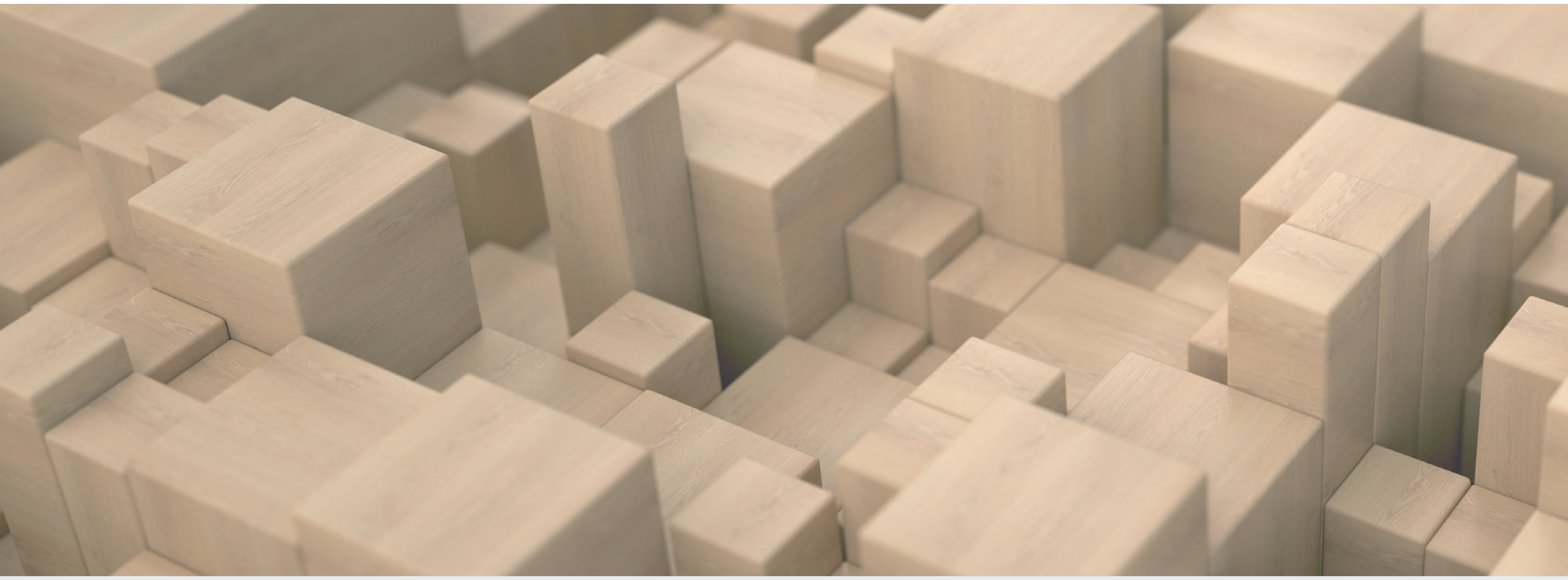
Plan sponsors should look to populate the "Retirement Tier Menu" with investment options that aim to provide income and cash-flow solutions and deliver modest asset growth while focusing on limiting downside risk.

POTENTIALLY SUITABLE RETIREMENT TIER OPTIONS MAY INCLUDE:

- Products that provide a targeted payout
- Products that preserve capital
- Annuity solutions that generate a portion of income
- Managed accounts

Along these lines, we believe effective Retirement Tier options may include **multi-sector bond** strategies that aim to provide reduced volatility but have flexibility to allocate across the entire fixed income opportunity set; **high yield** and **emerging markets debt** for additional return potential; **multi-asset income strategies** that further expand that investment universe to include real estate, dividend-producing stocks and other income-producing assets; and **equity income** strategies that combine stocks and bonds to provide both income and capital appreciation potential.

Plan sponsors should continuously review their investment lineup and look for opportunities to strengthen their offerings.



CONSIDERING RETIREMENT TIER POTENTIAL

As we've outlined, creating a Retirement Tier within a DC plan provides key advantages to both plan sponsors and participants. Retired participants can benefit from institutional pricing and carefully selected investment options while avoiding the uncertainty and pitfalls associated with moving their assets elsewhere. Plan sponsors can benefit from lower costs associated with scale, improve the quality of their plan offerings to attract and retain participants, and maintain more flexibility with regard to timing of retirement across the workforce. A Retirement Tier that emphasizes educating participants during all stages of an employee life cycle may improve a company's overall productivity and profitability by helping more participants retire on time. We believe a Retirement Tier is a valuable solution worth considering as plan sponsors face demographics that could fundamentally change the DC landscape.

[1] 22nd Annual Transamerica Retirement Survey, 2021.

[2] SeniorLiving.org, 2022.

[3] EBRI/ICI. 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2018, March 2021.

[4] Alight Solutions, 2019 Top Topics in Retirement and Financial Wellbeing: Building on the Past, Working Toward the Future, 2019.

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