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welcome to brighter

2020 vision

defined contribution

Top 10 areas of focus for plan sponsors

The more things change, the more they stay the same. The industry issues we are likely to see in 2020 are similar to those we highlighted for 2019. This should be no surprise given that litigation has stayed at the fore, the focus on fees remains, outsourced CIO (OCIO) has continued to grow, managed accounts continue to attract attention, interest in broader financial wellness continues and, as we predicted, the retirement phase of defined contribution (DC) plans has attracted increasing attention.

We think these fundamental issues will continue to evolve, and we therefore present the same three broad themes for 2020 — but with additional depth, detail and related action steps.

1. Secure your foundation.
In this litigious environment, ensuring that you have a strong governance framework in place is essential.

2. Achieve greater prosperity.
Sponsors should focus on improving participant outcomes (considering broader financial needs, not just retirement).

3. Inspire confidence.
By ensuring that retirement plans are geared to address the diversity of participant needs, not just those of the mythical average participant, sponsors can make participants more confident in their ability to achieve financial security on their own terms.

01 / Secure your foundation

Review the detail of your plan fee structures

Given the litigation focus on fees, we recommend clients review our *Defined Contribution Plan Fee Practices.*[1]

In addition, given recent litigation experience, plan fiduciaries should insist on disclosure of all relevant revenue streams accruing to their service providers.

Learn from current IRS/DOL audits

Internal Revenue Service (IRS) and US Department of Labor (DOL) audits are a reality. They typically focus on operational issues, such as missing participants, timely submission of contributions, plan assets being used to pay nonplan expenses, conflicted fiduciary decisions, and the use of proprietary funds and services. A governance audit can be a good way to ensure you are prepared for a potential audit.

Consider opportunities for outsourcing

Although not all sponsors want to outsource their investment decisions, either partially or fully, we have seen three key drivers behind the strong growth in OCIO:

- Plan sponsors trying to do more with fewer resources
- Focus on fees (particularly in litigation cases)
- Plan sponsors wanting to improve governance structure, mitigate risk, manage cost and deliver better participant outcomes

Outsourcing of ERISA 3(16) administrative responsibilities is also possible, though less common today, but that could change with recently signed legislation allowing open multiple employer plans (MEPs).

Watch out for:

Change, uncertainty — and volatility

The Setting Every Community Up for Retirement Enhancement (SECURE) Act passed into law in December 2019. We expect two likely outcomes from this momentous legislative development: a greater focus on retirement income and open MEPs becoming a catalyst for industry change.

An election year can create market uncertainty but also regulatory uncertainty.

This has been an exceptionally long US growth cycle. If the US enters a period with subdued or poor investment returns, DC investment lineups may come under new scrutiny.

[1] Mercer. *Defined Contribution Plan Fee Practices,* May 2019, available at https://www.mercer.us/content/dam/mercer/attachments/private/us-2018-defined-contribution-plan-fee-practices.pdf.

02 / Achieve greater prosperity

Consider an investment structure for 2020 and beyond.

- **Retirement tier**
- **ESG tier**
- **White label funds**
- **Company stock**

The streamlining of plans' investment lineups has largely and successfully reduced the "misery of choice" for participants. However, in recent years, we have seen a potential increase in lineups to address diverse participant needs while reducing unnecessary or overlapping investment options. Hence, sponsors are assessing:

- Whether adding a retirement tier makes sense for their plan
- Whether environmental, social and corporate governance (ESG) offerings are appropriate
- White label/multi-manager investment options — as one way to streamline choices, eliminate overlap, reduce manager risk and improve diversification

Review investment defaults and target date suitability

Nearly 75%[2] of DC plans use a target date fund (TDF) as their investment default. But is that right for your participant group?

- Would a dual qualified default investment alternative (QDIA) be more appropriate?
- Should the TDF integrate lifetime income features?
- What about personalized TDFs?

If you believe a TDF remains appropriate, be sure to review and evaluate the fund for its suitability to your participants. Do not just evaluate performance.

[2] PLANSPONSOR. *2018 PLANSPONSOR Defined Contribution (DC) Survey.*

02 / Achieve greater prosperity

Review plan leakage (including auto-portability options)

Retirement plan leakage has been highlighted as a contributor to America's retirement crisis, and almost 40% of Americans cannot cover a $400 emergency expense.[3] This shocking situation contributes to the prevalence of DC plan loans, which can result in increased leakage.

There have been a number of responses within the industry, including:

- Sidecar short-term savings accounts
- Short-term employer loans or income-smoothing services to balance the ups and downs of unpredictable pay
- Auto-portability initiatives

We advise that sponsors track and measure their 401(k) plan cash-out and loan activity before considering which actions should be taken.

Evaluate, review and monitor managed accounts

In principle, offering managed accounts to participants seems reasonable, as these accounts can give participants an opportunity to customize advice to their individual circumstances and facilitate retirement advice. But offering a managed account solution is a key fiduciary decision, so codifying an initial review and an ongoing monitoring process is critical. Managed-account issues that sometimes arise include incompatibility with a plan's TDF series, fees being above-market, nondisclosure of revenue sharing and opaque (or absent) fiduciary protections.

Watch out for:

More personalization

In an age where we expect personalization in every aspect of our daily lives (think Netflix and Google), will participants be satisfied with one-size-fits-all solutions? We are already seeing solutions develop that focus on:

- Personalized investment strategies — disruptive offerings that sit between managed accounts and TDFs
- Personalized retirement strategies, where one-size-fits-none solutions have historically been unsuccessful
- Personalized deferral recommendations, guiding participants on how much to defer and into which vehicle (pre-tax, after-tax, Roth) and which product/solution (DC plan, HSA, student loan, etc.)

It is early days for many of these, but this theme is likely to be with us for a long time and will materially change the DC plan experience.

[3] Board of Governors of the Federal Reserve System. *Report on the Economic Well-Being of US Households in 2018,* May 2019, available at https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf.

03 / Inspire confidence

Know your participants

An increased focus on workforce diversity has highlighted the need to move analysis beyond averages. We have been using demographic analysis to better understand the diversity within participant groups and as a key input into investment lineup and plan design.

Segmenting participant populations and creating representative personas can result in better plan design, communication strategies, investment lineups and TDF suitability assessments. They can also provide a more effective way to establish the need for retirement or ESG tiers of investments and offer a more robust format to assess the success of various initiatives.

Understand the broader needs of your participants

The use of participant segmentation and representative personas also provides the opportunity to better understand the broader financial needs (that is, beyond just retirement) of your employee base. In addition, loan activity can provide insights into short-term needs versus longer-term savings objectives.

Solutions are coming to market that help address issues such as short-term financial needs — whether to pay off student debt or save for retirement, or whether to save into a health savings account (HSA) instead of a DC plan. These solutions can be complex, but understanding the needs of your employee base will help you decide which of these may be worth pursuing for your employee population.

Be systematic and wide-ranging in your financial wellness efforts

A focus on financial well-being is more than just providing financial education; that has been tried for many years with limited success. For a successful financial well-being program, sponsors need to be more systematic to address the needs of both participants and the business. Here are a few ways to accomplish this:

1. Ensure you understand the diversity and the needs of your employees/participants.
2. Be clear about your program's business objectives.
3. Understand what your competitors are doing and what wellness-focused products and solutions are available.
4. Build a roadmap of what you aim to achieve, and then take action.
5. Track progress toward goals, and iterate where necessary. Build tracking (utilization and impact) measures into implementations, review the data carefully and be prepared to react.

Watch out for:

The importance of trust

DC plan litigation making newspaper headlines does not inspire participant confidence. Also, multiple surveys have highlighted that millennials, in particular, do not trust traditional financial institutions. Personalization is seen as one way to gain the trust of millennials and others. But trust is not easily earned — and all too easily lost. In addition, more personalized data creates its own set of issues:

- Data breaches and cybersecurity issues can result in significant loss of trust.
- Personalized recommendations may cross a line and feel intrusive (even creepy).
- Participant data has the potential to be misused (for example, to cross-sell).

We see the personalization of DC plans as an inevitability, and that will result in more personal data being stored, managed and monitored. Only through careful stewardship of personalized information will organizations in the DC industry be able to show they can be trusted. This will be a challenge and a topic of increasing prominence.

Plan sponsors will need to consider which of the priorities highlighted here are most important for their plans and participants.

Please reach out to your Mercer consultant to assist with setting your plan goals for 2020.

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