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Investment Corner | Participant Engagement | Fiduciary Perspective | On the Horizon

# SECURE Act 2.0: next steps for retirement legislation

*The future of defined contribution*

# next

Issue no. 7

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# Unravelling the tangled web: complexity and customization in retirement planning

Here at Nuveen, we believe ample groundwork is necessary to help employees attain lifelong financial security. As the financial services industry becomes increasingly complex so does retirement planning. Retirement savings options are expanding and are therefore being viewed as an integral portion of broader employee benefit packages. Thus, it is vital to gain necessary knowledge, acquire specific skills and line up qualified professionals to unpack this ever-evolving landscape for plan sponsors and participants.

In this edition of *next*, we revisit our real estate allocation recommendations while examining how the sector fared during 2020 market volatility. We also analyze how plan sponsors can apply financial psychology and brand bias awareness training to their selection process. Next, we dive into the key provisions of the Securing Strong Retirement Act of 2021 (nicknamed SECURE Act 2.0) that is currently working its way through Congress. Finally, we evaluate the rapidly growing managed accounts within plans to see what benefits customization could bring to participants.

We are in a period of fluctuation for the defined contribution industry. As the regulatory framework unfolds, participants are grappling with changes to their work life balance. It is crucial to align these sets of needs as financial education programs take shape. This issue of *next* aims to bring together the right insights, resources and people to offer meaningful education to plan sponsors and participants grappling with the issues of today.

**Your Nuveen Team**

INVESTMENT CORNER

# Rome wasn't built in a day: long-term trends driving real estate in volatile times

## The current state of real estate

*In the very first edition of* next *we discussed the potential benefits of direct real estate allocation in target date vehicles. Nearly three years later it is time to see how our hypothesis held up, especially after the ups and downs of 2020. Did the asset class perform as we expected it to? What has changed in the real estate investing universe? Is there an archetypal direct real estate allocation that should be part of a target date suite? We explore these questions and more in the following section.*

*We believe the ideal allocation to direct real estate is about*

**5%**

*of a target date portfolio*

## Private real estate in defined contribution

We believe that real estate plays an important role within target date strategies. The long-term focused asset class can be a differentiating factor in portfolios by creating a diversification benefit and producing additional income. In our opinion, the ideal allocation to direct real estate is about 5% of a target date portfolio. While other portfolios may have allocations to direct real estate of 5 – 15%, our analysis has shown the need to balance the additional yield and diversification benefits with liquidity challenges inherent to the asset class.

Referring back to *next* issue no. 1, analysis favors direct real estate over real estate investment trusts (REITs) because of the lower volatility and relatively high risk-adjusted returns.

FIGURE 1

### Asset class risk and return over the past 20 years

*(as of 31 Dec 2020)*

Real Estate, NAREIT All equity REITs (REITs). It is not possible to invest in an index. Performance for indexes does not reflect investment fees or transaction costs. Results may be significantly different for other time periods. Source: Morningstar Direct and NCREIF. Past performance does not guarantee future results.

The benefit of REITs is that they are much more liquid than direct real estate investments. That liquidity is derived from the fact that they represent a public market investment, and thus tend to move in a manner more similar to public markets. Specifically U.S. equities and REITs have a 0.71 correlation over the past 20-year period ending 31 December 2020. On the other hand, direct real estate only had a 0.15 correlation with U.S. equities over the same period. This information stands to prove the diversification offered by direct real estate in a target date portfolio.

FIGURE 2

### Low correlation to major asset classes

| 20-year period ending 31 Dec 2020 | Direct real estate | REITs |
|---|---|---|
| U.S. equities | 0.15 | **0.71** |
| Non-U.S. equities | 0.12 | 0.66 |
| U.S. bonds | -0.15 | 0.03 |
| REITs | **0.25** | 1.00 |
| Direct real estate | 1.00 | **0.25** |

Fundamentally, there are principal reasons to invest in real estate at this time such as the additional income generated by real estate. Additionally, real estate may provide a particularly attractive investment for investors seeking to hedge against inflation, at a time when inflation may be running above average. Further, rental prices and property values are highly correlated with rising consumer prices. Most long term leases have built in rent escalators that are tied to inflation, which protects the income generation of in-place leases. Residential leases tend to average twelve months and allow for adjustment, while office leases with longer contracts allow for less inflation buffering. The industrial sector also often offers medium- to long-term leases which can benefit from inflation driven by growth, as many properties currently have below market rent prices. Typical annual rent bumps are 2.0-3.0% as real estate owners need to keep up with the inflation of expenses as well. In the multi-family space, Nuveen Real Estate aims to institute at least 2.0% year-over-year increases in rent. We are sensitive to timing as we prefer annual increases. However, some retailers and industrial tenants will agree to mid-term increases and negotiate percentage rent which is based on exceeding a sales threshold.

Our target date portfolios remain committed to commercial real estate as a long-term investment. We believe our policy focusing on consistent income and stable tenants while monitoring current trends in alternative real estate investments will help position individuals for retirement. Our target date strategies enable participants to benefit from reduced volatility, improved risk-adjusted returns, enhanced diversification and inflation hedging.

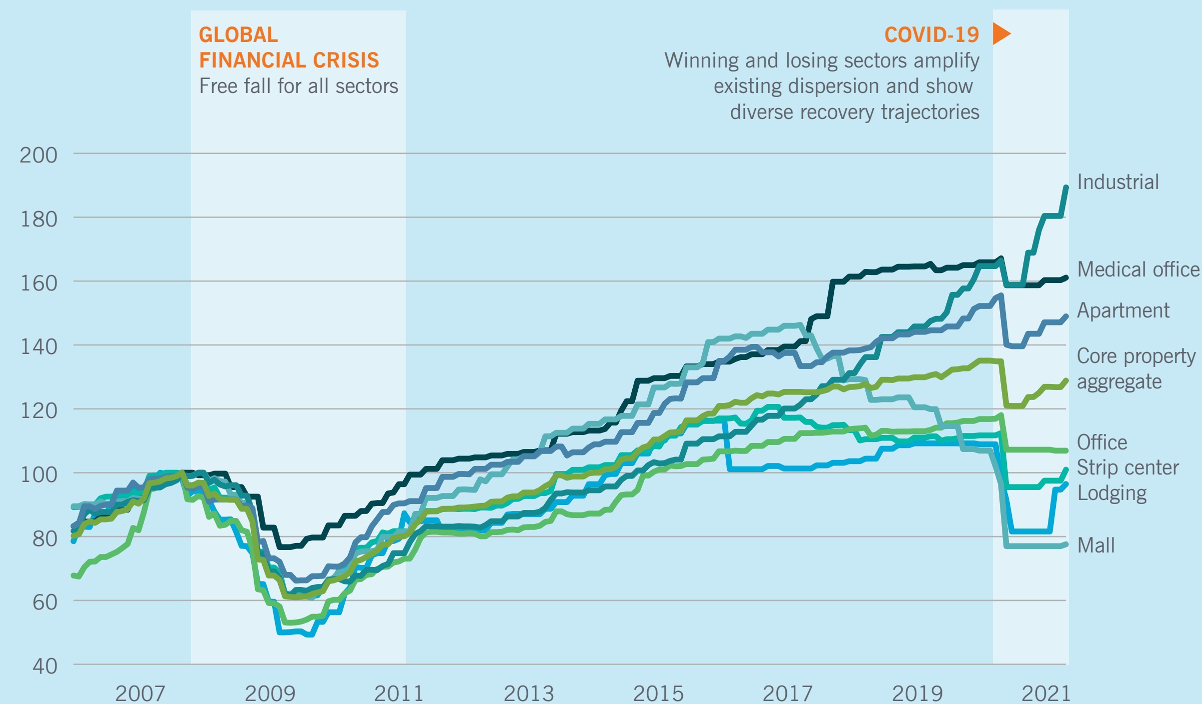
## Our direct real estate predictions

The principal driving force behind our outlook hinges upon continuing demographic trends that were accelerated by the COVID-19 pandemic. The aging millennial generation will continue to have outsized effects on the economy. Factors such as this generation having children at a later age when compared to prior generations and having lower rates of home ownership lead us to predict growth in single family rentals and other alternative real estate classes, such as self-storage. Further, this demographic is increasingly focused on the importance of ESG factors in real estate, both at home and at the office, so we see demand for services such as green energy projects growing.

## Not all financial crises are equal

The impact of the COVID-19 pandemic was harder on some commercial real estate sectors than others last year. While this may seem like an obvious statement, it is different from the great financial crisis of 2008 when pretty much every sector was equally hit, and saw roughly parallel rebounds (Figure 3). This time, the impact exacerbated trends that were extant in the marketplace. An example of this are struggling malls and lodging which were hit hard and have taken longer to recover. Whereas industrial buildings, medical offices and multi-family homes continued to do well. There were interesting conclusions to be drawn within sub-sectors as well. For instance, we saw resilience among grocery-anchored centers and necessity based retail (such as beauty, food & beverage and fitness) in contrast to the struggling brick and mortar retail sector. This was because consumers were increasingly buying durable goods on the internet, but were reliant on physical stores for groceries and services.

FIGURE 3
**Commercial Property Price Index (CPPI)**




Data source: Green Street, 01 Jan 2006 – 31 Mar 2021. **Past performance is no guarantee of future results.** Sectors represent components of the Commercial Property Price Index.

## Office space

The traditional office sector is one that has constantly been in headlines since the start of the pandemic, with the effects of work-from-home rippling through urban centers. While forecasts predict the majority of the workforce to be back in the office by the beginning of 2022, our near-term outlook remains fairly bleak. National office usage is around 25%, but improving over time. Net effective rents appear to be down around 10% nationally versus pre-COVID levels, though this varies by market and asset quality. Green Street, an independent research and advisory firm concentrating on the commercial real estate industry, forecasts the combined cumulative drop in effective rents and occupancy will bottom at 17% by the end of the year and slowly recover from there.[1]

We are seeing numerous properties under 80% leased, and while we expect fall to be a turning point, the sector will likely struggle for some time.

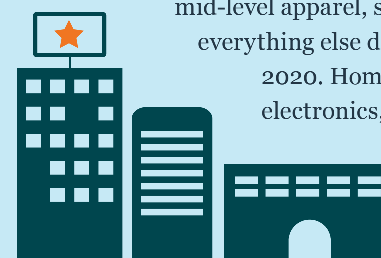
One difficulty is that leases are expiring, but no one is renewing or backfilling the vacancies. Furthermore, tenants who did commit to leases typically chose short term leases (around 12 months) as opposed to long term (five years or more). Office real estate has always been capital intensive as tenants moving into new office space demand more build out than other property types to accommodate business needs. This can slow down the process and make it more expensive for building owners. Additional ancillary revenue generators have also seen a collapse. Parking income has fallen precipitously, and ground floor retail units are often now vacant, or leased and not open for business. When tenants do return to the office it will take time to see the ecosystem recover fully.

## Out of office

Conversely, we are seeing strength in alternative sectors, specifically medical offices, self-storage, data centers and life science. These sub-sectors have additional yield (around 100-200 bps) which is beneficial at this time. While we are seeing the industry pivot to these property types, we particularly like the medical office sector. The pandemic accelerated a trend toward telehealth, and we believe non-hospital medical care is the sub-sector most insulated from potential negative effects of that transition. Further, the growth in outpatient procedures being performed in medical offices should drive growth in rents. We forecast medical office net operating income to grow from a 1.5% increase in 2020 to a 2.5% increase in 2021.

## Revenge of the retail

One much maligned sector where we see positive signs is retail. Consumers are revenge spending, and while certain sub-sectors, such as mid-level apparel, suffered, generally everything else did well during 2020. Home goods, tech, electronics, and groceries all saw strong sales. Brick and mortar retailers with internet sales, known as multichannel distribution systems, are a particularly interesting growth area. The delivery mechanism is efficient, and it minimizes problems with shipping costs and returns. Grocery-anchored centers and strip malls that are protected from e-commerce will also remain strong and exhibit attractive pricing relative to other asset classes.



## Home is where the growth is

Within alternative housing, single-family rentals are favorably positioned given the pandemic's impact on urban areas and millennials. During COVID-19, city dwellers fled major urban areas for the suburbs and Sunbelt cities. While it is unclear if this is a secular or cyclical trend, single-family rentals offer a permanent lifestyle change at an affordable price as many millennial households cannot yet afford homes. Self-storage is projected to outperform due to single-family rental growth, the sector's attractive initial yields and extremely low capital expenditures relative to traditional sectors.

## Healthcare vitals

The pandemic exposed the country's medical capabilities and thus the importance of medical innovation and discovery. The need for drug testing, therapies, and vaccines for future virus outbreaks will be paramount in the coming years which will ultimately fuel demand. Given the high levels of spending on medical offices in the U.S. relative to other developed nations, we believe more care will be delivered outside of hospitals in more cost effective settings such as medical offices.

## Technical support

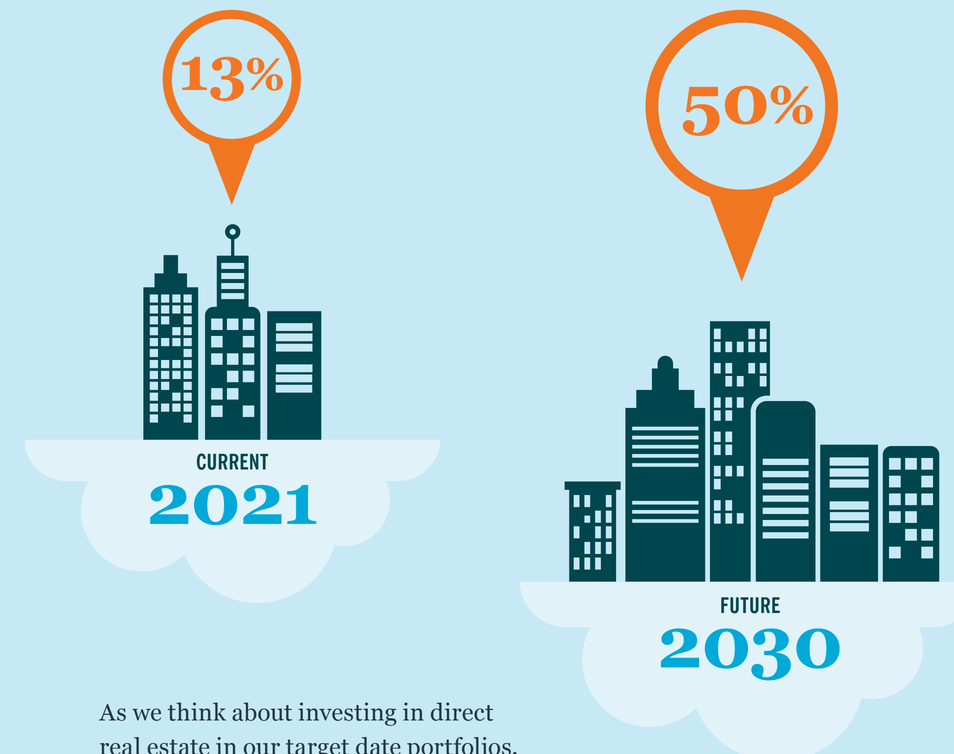
Alternative technology includes several sub-sectors, such as data centers, which have significant tailwinds behind them. Data centers increased in importance throughout the COVID-19 pandemic as large companies modified their IT infrastructures to ensure employees could effectively work from home. We believe this trend will continue as more companies provide hybrid, and in some cases, permanent work-from-home policies. Cell towers outperformed the broader real estate market during the pandemic as mobile data usage increased as consumers relied heavily on mobile products and online services. We expect the sector to benefit from structural changes that have been accelerated by the pandemic.

As mentioned prior, we see a macro-economic trend in the growth of medical offices and life sciences that will continue over the coming decade as they barely slowed during 2020 and continue to grow rapidly. Alternative technology plays an integral role in this evolution.

## The future of real estate

We expect our portfolio allocation within real estate to evolve over the next decade. We suggest moving toward alternative real estate classes, while maintaining core allocations to other favored sectors. We predict continued institutionalization of alternative real estate, specifically alternative housing, alternative healthcare, and technology (Figure 4).

FIGURE 4
### Alternative real estate asset classes
Housing | Healthcare | Technology




As we think about investing in direct real estate in our target date portfolios, we are examining burgeoning trends in the real estate market and looking to evolve our portfolios to capitalize on these trends, particularly within alternative real estate sectors. Maintaining an allocation to direct real estate allows individuals in our target date strategies to benefit from reduced volatility, improved risk-adjusted returns, enhanced diversification and inflation hedging, while being offered the ability to invest alongside institutional investors in rapidly emerging sub-sectors.

PARTICIPANT ENGAGEMENT

# What's in a name?

## Challenge

Helping plan sponsors avoid the common tendency and pitfall of naturally gravitating toward the easier, more common brand name options based on false, preconceived notions.

## Opportunity

Consider a "white label" approach during the investment selection and/or review process within the qualified default investment alternative (QDIA) category.

## Benefits

- Process can be a valuable differentiator.
- Provides fact based solutions, which eliminates emotional choices.
- Avoids certain behavioral finance missteps.
- Provides an unbiased, fiduciary approach to investment selection.
- Best of breed options clearly analyzed regardless of branding or preconceived notions.
- Plan sponsor grasps the importance of the investment due diligence process.
- Plan consultant able to demonstrate/highlight the value of their role as it pertains to true, unbiased investment due diligence.

## What is bias?

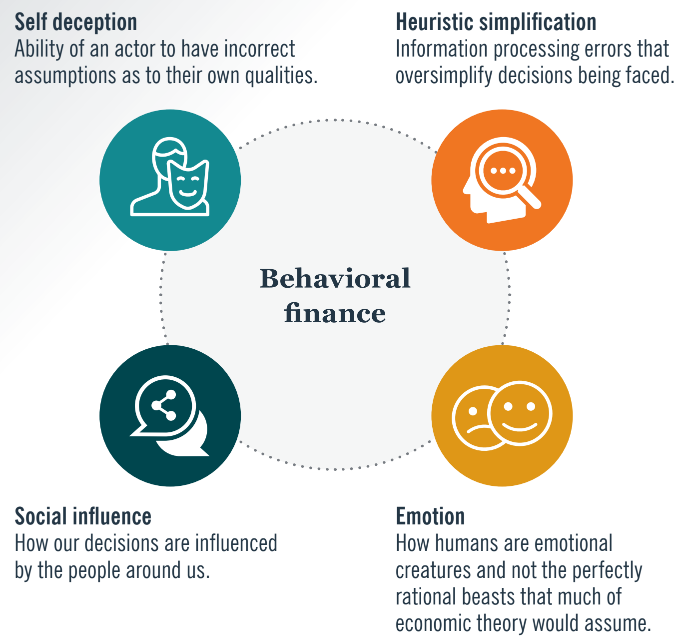
Inherent biases are all around us, whether subconscious or more overt. The schools of thought around cognitive bias have grown massively of late, and how the field of study can be applied to corporate activities has become a hot topic. The field of behavioral financial theory is the directed study of psychological influences on investors and financial analysis. Broadly evolving from the underlying study that investors are not always perfectly rational, the field examines how investors can act against their self-interest, and can fail to objectively examine potentially more appropriate investment options.

More specifically, different types of group-think, loss aversion, and overconfidence all feed into types of bias that can impede a plan sponsor's ability to identify the best investment options for participants. In this article we will examine a number of key bias types that can have an impact on collective decisions. We will examine how they may apply to plan sponsors and why we may want to work to combat these biases.

FIGURE 5

## Behavioral finance

The basis of behavioral finance can be broadly categorized into four key areas:




These four principles are, in essence, embedded in human nature, but a basic awareness of how our brains can conspire against our interest in making purely rational choices can have profound consequences when it comes to examining potential investment options.

### Plan sponsor committee meetings

Within the context of plan sponsors' planning options there are several more sets of biases to bear in mind, many of which are most potent within a group setting where communication might be challenged and time pressures may amplify errors.

Confirmation bias is the way that the human brain generally dislikes information that disagrees with preformed notions. New information that is presented is interpreted as reinforcing the decision that has already subconsciously been made. Within the context of plan sponsors this is especially relevant when given information regarding different fund options; the brain has already decided on a recognized brand of asset manager, or the fund with simply the lowest fees, and information that is gathered simply reinforces that decision, rather than challenges it. This poses particular difficulties in organizations where there is a hierarchy, as it can be tough to challenge senior leadership and push for new data to be interpreted in a way that pushes against preconceived decisions.

The sunk cost fallacy is common in investing more broadly, where costs, time and effort already put into a decision or investment count against conceding that the decision was incorrect. This is particularly relevant to plan sponsors when it comes to changing options, as the time, due diligence and overall effort put into adding funds to platforms means that even if those funds are underperforming or no longer the best options available, it can be difficult to change course.

Herd mentality, the tendency for groups of people to think as a single group, rather than as a collective of individuals, is relevant in investing and fund selection due to the pressures of operating as a Board or a Trust. Maintaining independence and the confidence to push back against the group is vital to overcoming this bias.

### Applying this knowledge

The key is understanding the potential impact on plan sponsors and where these underlying biases can have a profound impact on decision-making. To apply this theory to plan sponsors and choices of funds that should be available for participants, we began to incorporate a "white label" approach in our finals scenarios. We encouraged breaking away from simply looking at the lowest fees, or funds that came from the best-known brands, or those that had sat in the top decile of performance for the most recent timeframe. Each of these elements may be erroneously utilized to justify investment decisions. We believe that incorporating a more holistic approach to fund selection is a more prudent process when building or adjusting a plan lineup.

It is critical to have a plan sponsor recognize that just because a fund option has been around the longest and/or has the lowest listed fees does not necessarily mean that it should be considered as the default option. That position, "if it's been around the longest it must be the best" or "it is cheapest therefore we should choose it,", lends itself very easily to many of the bias characteristics outlined above. Deeper analysis, double-blind viewing of investment options and breaking away from group-think can ultimately lead to better options being considered and potentially chosen.

The consultants that approach analyzing investment options in an unbiased blind manner can be a valuable differentiator. That the selection of investments is un-incentivized for the consultant and is a demonstrably non-biased approach, can have a range of valuable consequences. Having these conversations and having a plan sponsor buy into that approach can again allow broader options to be considered outside of those with the easiest brand recognition or lowest fees.

In the following anonymized-but-genuine example in Figure 6 we compare two large index target date providers. Company B has arguably a more recognizable name brand. However, when looking at the double-blind example, our focus is off the brand names and is more appropriately directed towards the more important aspect of performance. While Company A has a lesser known name, it has consistently outperformed Company B in every listed timeframe.

FIGURE 6

*Performance as of 31 March 2021*

| | | Average Morningstar % Performance Rank | | | |
|---|---|---|---|---|---|
| **Target Date Series** | **Expense Ratio** | **1-yr** | **3-yr** | **5-yr** | **10-yr** |
| Company A | 0.10% | 50 | 13 | 15 | 8 |
| Company B | 0.09% | 58 | 41 | 38 | 26 |

## *Summary*

*Analyzing investments using a white label approach allows us to discern the more important factors for the plan sponsor. Performance, fees and risk-adjusted measures are all considered.*

## How do we approach these issues in an unbiased manner?

Remove the brand name and emphasize the facts.

- This process truly aids in the ability of the consultant and the plan sponsor to be on the same page when analyzing the investment lineup through the lens of a fiduciary.
- The result should be a first in class, well-vetted lineup determined by analyzing the most critical data points, rather than the brand. Thus ultimately providing the best solution for the retirement plan and its participants.

FIDUCIARY PERSPECTIVE

# SECURE Act 2.0:

## *next steps for retirement legislation*

*The Setting Every Community Up for Retirement Enhancement Act of 2019 (hereafter referred to as SECURE Act 1.0) was signed into law almost two years ago. It was a significant milestone in cementing the legislative structure around retirement savings and included a number of key provisions that would make it easier for people to achieve lifetime income.*

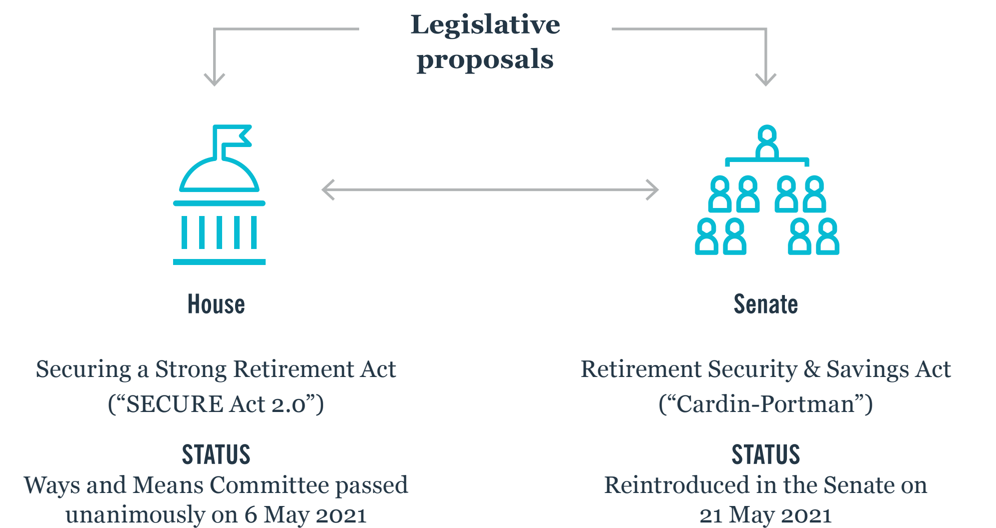
For more information on the key provisions in the SECURE Act and how it changed the retirement security landscape, click here.

*However, as with any piece of legislation, there were provisions that did not make the final cut, and areas where the new legislation opened up areas of inconsistencies that the retirement industry wanted closed. As such, even before SECURE Act 1.0 was signed into law, follow-up legislation was already being contemplated and drafted to continue building that framework and address remaining holes.*

*For those who are not familiar with the Washington D.C. legislative process, it should be known that it is not uncommon for law to be generated in such a way. Varying members of the House or Senate take on the responsibility for drafting new legislation and walking it through various relevant committees, before passing the bills on the floors of the respective chamber. The draft legislation then goes into a process whereby the two varying drafts become one final proposed piece of law, before being voted on one final time and going off to the White House for the President's signature (or veto).*

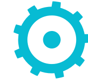
## System update in progress

In May 2021 the House Ways and Means Committee unanimously approved H.R. 2954, the Securing a Strong Retirement Act, which has been dubbed SECURE Act 2.0. There is also a legislative proposal in the Senate called the Retirement Security & Savings Act, which is seen as the partner to the House bill.



Around 30 provisions overlap between the two drafts, but many more do not. Thankfully, retirement is one area where the usual partisan political process falls somewhat by the wayside and despite the lack of overlap, almost all of the provisions between the two bills have bipartisan support and are considered non-controversial. For example, SECURE Act 1.0 passed in the House by a vote of 417-3 in May 2019. The House bill was passed by the Ways and Means Committee unanimously, underlining that point, and the Senate bill would be expected to receive similar support.

Yet strong bipartisan support does not translate to swift action. Due to the packed congressional calendar, there are other legislative priorities vying for time on the Congressional floors. This year the President wishes to drive infrastructure spending through Congress, there is an impending scuffle over the debt ceiling, and other priorities always emerge at the last minute. While they were more optimistic earlier in the year, our TIAA Government Relations team now thinks the path to enactment of SECURE Act 2.0 in 2021 is a narrow one. While 2022 is a midterm year, which throws an additional wrench in the works, the bipartisan support for retirement reform should make this less of a hurdle than it could otherwise be in a time of heightened bipartisan obstinacy.



## Version 2.0 Fixes

### CITs in 403(b) plans

Collective Investment Trusts (CITs) have been available in 401(k) plans for a fairly long amount of time, and much ink has been spilled over the benefits of CITs in those plans. While CITs currently make up over a quarter of the assets in 401(k)s and are set to continue growing, CITs currently remain unavailable in 403(b) plans. The reason is quite simply a regulatory anomaly that goes back a long way. There is no underlying policy rationale for the difference in treatment. It has however taken a long time to get this anomaly fixed. The governing rules are part investment regulation, part ERISA and while initial legislative fixes were first introduced in 2018, little progress has been made since. A provision to fix this differentiated treatment is now in both drafts moving through Congress.

### MEPs and PEPs

Increasing access to retirement plans for employees remains critical. SECURE Act 1.0 made some significant improvements to the legislative structure around Multiple Employer Plans (MEPs). Prior to SECURE Act 1.0 MEPs were limited as to the types of employers that could join a MEP, the with the most restrictive limitations being the commonality clause and the ‘one bad apple’ rule. The initial Act removed these restrictions to make it easier for employers to sponsor a retirement plan for their employees.

- **MEPs (multiple employer plans):** Old-style MEPs, which existed before SECURE Act 1.0 was passed and can remain in place, allow related businesses, such as those in the same industry or region, to band together under one plan.
- **PEPs (pooled employer plans):** allow unrelated employers that don’t share a common industry or location to participate in a single, shared 401(k) plan.

An extension of the MEP rules, Pooled Employer Plans (PEPs) are a slightly broader category of MEP that allow more unrelated employers to group together to form a plan, as long as it is sponsored by a Pooled Plan Provider. However, 403(b) plans were left out of the original SECURE Act 1.0, and as such are still constricted by the old rules. SECURE Act 2.0 would clarify that 403(b) plans may be maintained as a PEP under the same rules that apply to 401(k) plans even if participating employers share a common interest other than having adopted the 403(b) plan.

### Student loans payment provision

Record-level student loan debt can be a major obstacle to saving for retirement. Under current law, a payment made on student loan debt cannot be matched by an employer in terms of retirement savings contributions. The proposed legislation would treat student loan payments as elective deferrals to the participant’s retirement plan. As such, an employer could make matching contributions to the retirement plan as though the student loan repayment had instead gone into a retirement plan.

This provision in SECURE Act 2.0 will help younger people build their initial retirement plans at a time when they are otherwise making the most significant contributions to paying down student loans. We all know the benefits of saving early and the compound interest calculations that follow, and allowing employers to make matching contributions at a time when the participant may not have the excess liquidity to do so can provide an early start on building that retirement nest egg. This combined with the provision for employers to auto-enroll new employees in retirement plans could have a significant impact on those all-important early years of savings.

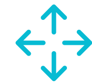
### Increase in the RMD age

Increased longevity has major implications for retirement plan design. SECURE Act 1.0 established that Required Minimum Distributions (RMD) must begin by the age of 72. Prior to the original Act passing, the RMD age was 70 ½ years old. The current drafts for SECURE Act 2.0 continue the trend of raising the RMD age, but they take slightly different approaches. The House bill raises the RMD age by single-year increments at various stages over the 10 years following the bill becoming law, up to 75 years of age beginning in 2032. The Senate bill, however, simply looks to year 11 after the statute is passed, and raises the RMD age to 75 in a single leap. However, the impact should be relatively minimal on retirees, as some 80% elect to take more than their RMD amounts. But for the 20% remaining, the additional time allows for additional planning and asset growth.

### Higher catchup limits

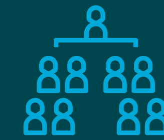
Under current legislation, workers that are at least 50 years old can make a number of catch-up contributions to retirement accounts. For 2021 those limits are $6,500 above the $19,500 limit that can otherwise be contributed to a 401(k) or a 403(b) plan. Under the House's proposal workers between the ages of 62 and 64 would be able to contribute an additional $3,500 to their plan, making the catch-up contribution limit $10,000 above the $19,500 for each of those three years. The draft Senate text would simply lift the additional catch-up contributed limit to the $10,000 limit (again above the $19,500 limit) at age 60.

Of note though, in the House bill, all catch-up contributions (participants age 50 and above) must be made on a Roth basis, i.e., after tax. Another Roth provision in SECURE Act 2.0 says that a plan may permit an employee to designate matching contributions as Roth as well. However, as this is on a Roth basis, this is considered a proposal that would actually raise revenue. It would also mean that a plan sponsor offering a retirement plan would have to be able to take Roth contributions. The current version of the Senate bill does not legislate that the catch-ups must be made on a Roth basis.



## How this impacts plan fiduciaries

It is critical to have an understanding of these provisions and their potential impacts on your plan today, even prior to legislation passing. Retirement benefits are increasingly viewed as a component of an organization's benefits package or an employee financial wellness strategy. As employers commence their annual plan reviews, they can work with service providers to understand how they can help implement best practices related to student loan repayments, participant communications and engagement plans, financial wellness tool upgrades and investment vehicle availability. There may even be time to help design offerings that would help meet the specific needs of a plan in order to keep retirement and wellness benefits competitive and best in class, while helping to ensure a smooth transition and compliance once legislation is passed.



| House | Provisions | Senate |
|---|---|---|
| Amends regulations to allow 403(b) plans, for the first time, to offer CITs | **403(b) Investments** | Same/similar |
| Allows for open 403(b) MEPs/PEPs | **403(b) MEPs** | Not included directly, but is in other bills in the Senate |
| Permits employers to make matching contributions based on student loan payments | **Student Loan Payments** | Same/similar |
| Increases the RMD age to 75 in three phases | **Increase RMD Age** | Increases the RMD age to 75 effective 2032 |
| Establishes an increased catch-up limit ($10,000) for those age 62, 63, and 64 | **Higher catch-up limits** | Establishes an increased catch-up limit ($10,000) for those age 60 and older |

ON THE HORIZON

# Getting personal: innovation in defined contribution

*There are certain conveniences we've all come to expect in our daily lives. Conveniences such as streaming services providing a menu of suggested shows based on our viewing preferences, meteorological services predicting the weather within a mile of our exact location, music software curating customized playlists based on our listening history and medical websites providing possible diagnoses for our health issues. We are increasingly expecting predictive technology to improve our daily lives. This begs the question, why don't we expect the same level of customization in our retirement plans?*

This is not to say that the retirement industry has been stagnant. On the contrary, legislative and regulatory changes (the Pension Protection Act of 2006), operational advancements (auto enrollment and auto-escalation) and product innovation (dynamic asset allocation in target date funds) have all had a major hand in shaping defined contribution plans over the past two decades.

However, increased focus on fees and vehicles coupled with a dramatic rise in DC litigation seems to have shifted attention away from long term outcomes, thereby stalling innovation.

**52%**

**of employees**

*(up 17% from 2020) said they plan to look for a new job in 2021*

**We see the pendulum swinging back based on multiple converging forces:**

### Legislation

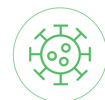
The SECURE Act of 2019 was the most comprehensive retirement reform legislation passed since the Pension Protection Act. The groundbreaking legislation was intended to shift the perception of defined contribution plans as retirement savings vehicles to retirement income vehicles.

### Demographics

Extended life expectancy, increased income inequality and significant debt for young employees are some of the reasons saving for retirement is more difficult today when compared to previous generations. This increases the need for holistic solutions including customization.

### Plan design

Plan fiduciaries and service providers are viewing plan design in a more holistic and strategic manner. They are able to offer an attractive, competitive plan by leveraging data aggregation and technological tools which ultimately increase financial wellness.



### COVID-19

The global pandemic continues to have major effects on labor markets. 52% of employees (up 17% from 2020) said they plan to look for a new job in 2021 citing better compensation and benefits as the primary reason, followed by better work-life balance.

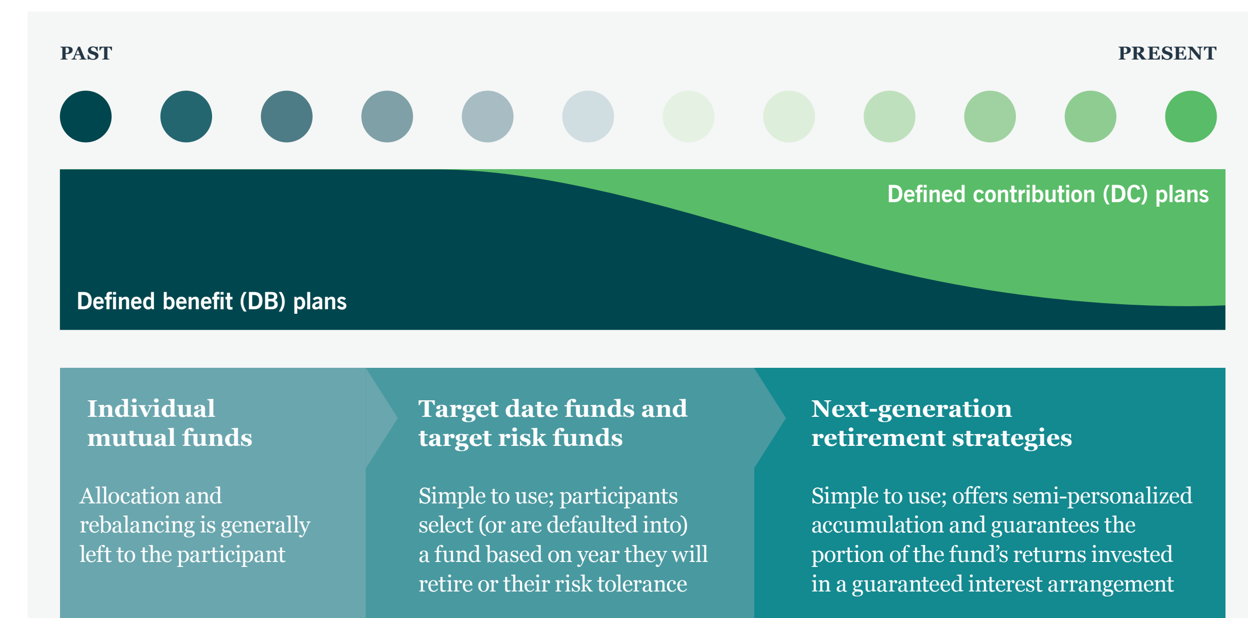
## Investing in employee financial wellness

With this information in mind, it's no wonder nearly half of plan sponsors view their retirement plan as a way to attract and retain talent. To do so, they're focusing on the needs of employees, which are increasingly intertwining with the needs of the company.

Financial wellness, planning and education offered by employers are adding value to the employee experience. A successful financial wellness program often includes planning tools, advice models, education seminars, access to financial planners and sound investment solutions among other things, all tailored to an individual employee's personal situation. A common exception to financial wellness programs are investment solutions, which were created for a more general audience.

In earlier times, the popular default investment options were balanced funds and stable value funds, which are arguably a 'one size fits all' approach to asset allocation. Target date funds evolved to take a 'one size fits most' approach by shifting a participant's asset allocation based on age cohort and the corresponding expected retirement year. Managed accounts have the ability to further tailor asset allocation based on an individual's data beyond just birth year and predicted year of retirement.

FIGURE 7
**Investment evolution**



The concept of a standardized risk-return model becomes increasingly challenged as employees' age, retiree longevity, health concerns, family planning and income changes all mean that employees need different solutions. As decades pass and retirement grows closer, an argument can be made for more complex risk-return profiling. Additionally, evidence shows employees become more educated and engaged regarding retirement options over time.

Without additional information, customization will be of a lower quality. Data that a managed account provider may request includes date of birth, detailed demographic information and the participant's current financial situation. To be clear, target date funds are a solid first step toward customization, especially when compared to placing assets in fixed asset class allocations that are not rebalanced over time. Target date funds still present an adequate asset allocation strategy for the majority of plan participants. However, for those with balances or circumstances that require a more customized solution, managed accounts can provide a higher level of service.

## Participation required

As we have seen across our interactions on the web, the user has to be willing to give up personal data in order to share a level of specificity with the system. Furthermore, to truly build a customized managed account the provider would need to do additional data gathering, including surveys and deep financial information. While those steps will yield a more customized solution this presents a significant deterrent for participants. As such we have identified two levels of managed account product for participants. The higher level is based on general data the participant has already shared with the provider. The second level is much deeper. It is based on supplemental data that produces more refined investment options. This is done by factoring in broader asset classes, risk levels and overall tolerance of the client.

An emerging component of managed account customization provides further advantages as the accounts can now use non-core options. A known limitation of managed accounts is that they are typically constructed with the 20 – 25 funds on the plan's core menu of available investment options. Non-core options mean managed account providers have the ability to select options a participant may not otherwise have been able to invest in. The active manager is able to utilize a much broader range of alternative asset classes that may require expertise, such as direct commodities exposure. This capability has the power to add significant levels of diversification and additional return, and include options that the participant may not have the required expertise or ability to otherwise invest in, such as direct commodities exposure. This obviously requires that the record keeper and plan sponsor have the necessary capabilities in order to have non-core options. We believe the benefits are worth the additional work.

Personalization will also help drive in-plan annuities offerings, and annuities will in-turn drive that personalization. Managed accounts help generate better income options tailored to participant needs, and core options for annuities enhances that optionality. Therefore creating a mutual symbiotic relationship. The inclusion of managed accounts and annuities in core offerings empowers participants to incorporate guaranteed lifetime income into their plan, which is a significant area of growth and opportunity.

## Key considerations

It is necessary to discuss the value versus cost of personalization. Additional customization and complementary investment options within managed accounts generally carry higher fees compared to other vehicles. During a period of declining fees and tough conversations justifying fees it is important plan participants understand the reason behind the price tag. We would like to emphasize this solution is not for everyone. The target date glide-path might be sufficient for the risk-return profile of most participants. However, for participants who want or need the custom tailoring, the structuring could well be worth it.

The record keeping element of managed accounts is another important factor. The emphasis is firmly on the record keeper to set up the managed account access, but this is often outsourced to a technology provider. This of course carries its own risks and requires due diligence. It is important to implement a system to facilitate a conversation with a third party consultant or advisor. This system is necessary to facilitate pipes from the investment advisor into the record keeper into the plan down to the account before they can manage that. Many record keepers only offer one managed account service to participants as a result of the complexity, but this is still an emerging market and we see progress being made.

## *Our advice*

*Leaving well enough alone is not an option for plan fiduciaries. Putting participant outcomes at the forefront of the decision-making process and understanding the evolution of investment design are critical. The retirement industry is heading for a period of innovation, and plan fiduciaries will be at the forefront of that change.*

*The future of defined contribution*

# next

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**Endnotes**

1 Taken from Nuveen Real Estate Research Commentary.

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