We offer predictions — both realistic and ambitious — on how DC will change in five years and beyond

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If the past is prologue, the next several years will be a fertile time for change in the defined contribution landscape. The DC world has made considerable strides in recent years, developing new rules and tools to keep up with seismic shifts in the ways Americans save for and fund retirement. Efforts to better understand participants’ saving and investment behaviors have led to groundbreaking plan design features such as automatic enrollment and investment solutions such as target date funds.

Although change doesn’t always happen quickly in DC — some might even say the pace is glacial — we expect the industry to continue evolving to serve participants better. We asked colleagues, plan sponsors and industry experts to weigh in on where they think the DC industry will be in 2020, just five short years from now. Our conversations focused on four areas: retirement planning, plan design, investment design and public policy.

RETIREMENT PLANNING
A SHIFT TOWARD OVERALL FINANCIAL WELLNESS

Where are we now? Participants increasingly understand that retirement can begin only when they have the financial capacity to stop working. Yet many plans are built around the assumption that most people will retire at 65. What’s more, DC plans focus almost exclusively on retirement savings in isolation — but to build long-term financial security, many participants need guidance for managing their overall financial lives.

A growing body of evidence shows that employees’ financial worries have a major impact on productivity. Our own surveys at State Street Global Advisors find that 4 in 10 workers say financial stress has caused their workplace productivity to suffer.1

Where are we going? During the next five years, the DC community gradually will change the conversation from retirement planning to financial wellness. This shift has already begun: More than 90% of plan sponsors expect to begin focusing on or expanding their financial wellness efforts this year.2 Over time, plan sponsors will find more ways to encourage saving in the context of participants’ full financial lives, including discussing their debts and spending habits. “Employers who can address employees’ needs holistically will win the war for talent,” says Megan Yost, head of DC participant engagement at SSGA.

How will we get there? Some plan sponsors have already begun evaluating their participant populations to better understand the areas where employees feel financial stress most acutely. Ron Virtue is director of investments for JM Family Enterprises, a diversified automotive company headquartered in Florida with more than 4,100 associates. The company is considering several initiatives to boost participants’ financial wellness. Currently, associates have the opportunity to meet with financial planners at no cost. The company is looking to improve awareness of that service as well as provide more resources. “Studies show that associates who are more secure about their financial future are happier and more productive,” says Virtue. “Ultimately, that’s good for our culture and our company.”

Bold prediction: What were once known as retirement benefits will expand considerably. Employers will offer financial benefits that include retirement as one feature among many.

PLAN DESIGN
MORE FOCUS ON THE INCOME OUTCOME

Where are we now? Individual investors often buy high and sell low. That’s the main reason the average equity mutual fund investor has earned just half the annualized return of the S&P 500 over the past 20 years, according to investment research firm DALBAR Inc.3

DC plan design has used target date funds, automation and other means to address such behavioral challenges. It hasn’t gone far enough, however. The standard approach still assumes that the key to making money last through retirement
is to accumulate a big enough account balance. Accumulation is critical, of course, but hitting a target savings number doesn’t guarantee sufficient and sustainable retirement income.

**Where are we going?** We expect that by 2020 plan design will focus on *outcome-based investing*. Rather than encouraging participants to shoot for a particular savings target, plan sponsors increasingly will emphasize the amount of income their savings can generate over the course of retirement.

We’ll see that effort borne out primarily in participant communications. Plan sponsors will need to engage participants to change the conversation from accumulation to retirement income. Some large financial services firms already are making massive changes to their marketing messages to shift the emphasis to income.

The upshot: By 2020, DC plans will offer income solutions with cost structures more favorable than out-of-plan options. These options will help participants create the regular, and possibly guaranteed, income stream they need during retirement.

**How will we get there?** The government will provide new or updated safe harbor guidance related to both income estimates and the inclusion of annuities in plan design. This policy shift will enable plan sponsors to translate retirement savings into income estimates, giving participants greater clarity on their retirement readiness.

**Bold prediction:** In-plan income options will become standard, leading retirees increasingly to keep their assets in their employers’ plans. As a result, the assets rolled into IRAs at retirement will drop dramatically.

MORE THAN 90%

of plan sponsors expect to begin focusing on or expanding their financial wellness efforts this year.²
INVESTMENT DESIGN
GREATER USE OF ALTERNATIVES
TO MANAGE RISK

Where are we now? Target date funds have enabled participants to select a single investment that provides a diversified portfolio, with allocations that become more conservative as the participant approaches retirement. But target date funds aren’t perfect. In particular, the industry lacks consensus about the best ways to manage risk for retirement investors. As a result, different target date funds hold a wide range of equity allocations during the 20 years leading up to retirement, known as the roll-down phase.

Where do we think the DC industry will be in 2020 and beyond? Send your thoughts and bold predictions to theparticipant@ssga.com.

Where are we going? One solution is for target date funds to hold a wider variety of asset classes. For years, Texas-based grocery chain H-E-B has used alternative investments such as hedge funds, private equity and oil and gas partnerships in the risk-based funds offered in its 401(k) plan. Tom Witt, director of H-E-B’s savings and retirement plan, notes that alternative and traditional asset classes have relatively low correlations to each other, so diversifying among them may help smooth and potentially boost returns during weak periods for stocks.

How will we get there? We expect that by 2020 more plan sponsors will offer custom target date funds, enabling them to incorporate a range of asset classes such as hedge funds and other alternative investments. Other investment design improvements also will drive better results for...
participants in the roll-down phase. For example, some custom target date funds may adopt downside protection strategies to manage risk exposure more precisely in real time, as part of a general trend toward investment products that help limit downside risk for participants who are approaching and in retirement.

**Bold prediction:** As plan sponsors see that target date funds deliver improved participant outcomes — including higher balances, less drawdown risk, fewer negative investing behaviors and stronger retirement income — they will eliminate all other investment options, distilling 401(k) investment menus to target date funds and self-directed brokerage accounts.

**PUBLIC POLICY**

**EXPANDING ACCESS**

**Where are we now?** The private retirement system is one of the few legislative topics that enjoy broad, bipartisan support. But many other divisive policy issues could indirectly affect the DC landscape. For example, while tax reform looks stalled for now, it could have a profound impact on DC plans down the road, according to Melissa Kahn, a managing director and retirement policy strategist at SSGA. (For more from Kahn on potential changes in the DC policy landscape, see “DC Download,” page 4.)

**Where are we heading?** Kahn says policy changes are likely in two areas: efforts to boost access to workplace retirement plans, and the merging of financial and personal wellness.

Kahn says it’s been more than a generation since public policy has changed much to expand the number of people covered by workplace retirement plans. One key sticking point is small businesses, which often can’t afford the administrative cost to manage a plan for their workers. States are experimenting with ways to help. “The needle hasn’t moved in 40 years, and now states are taking it into their own hands to create plans for small employers,” she says.

To advance personal health and financial well-being, prominent industry voices including the American Benefits Council are advocating for changes to help individuals manage retirement income and health care simultaneously. Among the council’s proposals is one that would allow contributions to tax-favored retirement plans to be used, without penalty, to pay for health care costs and long-term care during retirement. “The idea is to not look at these things in separate silos,” says James Klein, the organization’s president. “One of the biggest elements of retirement security is having sufficient assets to pay for these needs.”

William Hoagland, senior vice president at the Bipartisan Policy Center, a Washington, D.C., think tank, supports efforts to help retirees cover the cost of health care. “Health care issues tend to crop up right in the middle of retirement, where costs can become a real financial issue for many people,” he says.

**Predictions from Plan Sponsors**

Plan sponsors have unique takes on the challenges and opportunities in the DC world. We spoke with two plan sponsors — Ron Virtue, director of investments for diversified automotive company JM Family Enterprises, and Tom Witt, director of the savings and retirement plan at Texas-based grocer H-E-B — to get their thoughts on how the DC landscape will change in the coming years.

**MORE EDUCATION.** Virtue expects to see plan sponsors and administrators emphasize participant financial education. “Many participants are looking for more guidance and support, while the industry is assessing whether that’s worth the extra cost,” he says. Ultimately, says Virtue, many sponsors will determine that more guidance has long-term value — and that helping participants gain a better understanding about their financial decisions will be a net benefit for all parties.

**THE QUESTION OF ACTIVE MANAGEMENT.** Witt knows that many plan sponsors are pushing for a more passive approach to investment management. “I understand the desire to go more passive,” he says. But he notes that not all market environments support this approach and being passive in the wrong market may pose greater risk to performance. Witt says he focuses on active trading to try to boost performance in low-return environments. “I don’t want participants making that choice, but I’ll make it for them,” he says. “Managing assets is a full-time job.”

**FINDING INCOME.** Virtue and Witt agree that more must be done to bring lifetime income solutions into DC plans. Virtue notes that participants need help understanding the pros and cons of lifetime income products. “Many people don’t understand the concept of retirement drawdown as income rather than as a lump sum,” he says.
How will we get there? Many states are supplying an interesting path forward for access: To date, 17 states have proposed or enacted legislation paving the way for state-sponsored retirement plans that can be used by small employers and their employees. “A big litmus test will be to watch what happens in places like California and Illinois,” Kahn says. “How will these plans affect the state’s finances and its budget? The more positive results we see, the more growth we’ll see in these plans.”

Klein at the American Benefits Council says his organization and others are pushing for changes to rules governing employer-sponsored arrangements. “The regulatory environment for retirement plans is extraordinarily complex,” he says. “And that complexity is an impediment to employers to provide these types of plans.”

Bold prediction: State-by-state rules will create a patchwork of different plans for private employers to negotiate, leading federal lawmakers to enact legislation requiring all employers to provide a retirement plan vehicle for their employees. These plans won’t impose any substantive costs on employers, which will only need to transfer employee contributions to these plans.

A LOOK AHEAD

Five years can pass quickly, and may seem like too little time for the forecasts above to incubate. But to quote Abraham Lincoln, “The best thing about the future is that it comes one day at a time.” The improvements of the past five years are the result of the DC community’s continual, day-by-day efforts to make defined contribution plans more effective for participants and plan sponsors. One prediction we are sure about: Those constant efforts will continue, and will improve the system in both incremental and revolutionary ways. We are thrilled to participate in that process — and we can’t wait to see what comes next.

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1 State Street Global Advisors, “March 2015 DC Investor Survey,” 2015. Survey data were collected in January 2015 through a 20-minute Internet survey using a panel of 1,009 verified 401(k), 403(b), 457(b) and profit-sharing plan participants, aged 20 to 69, who were working at least part-time.


Watch Matthew Ketchum discuss the future of DC at ssga.com/definedcontribution.