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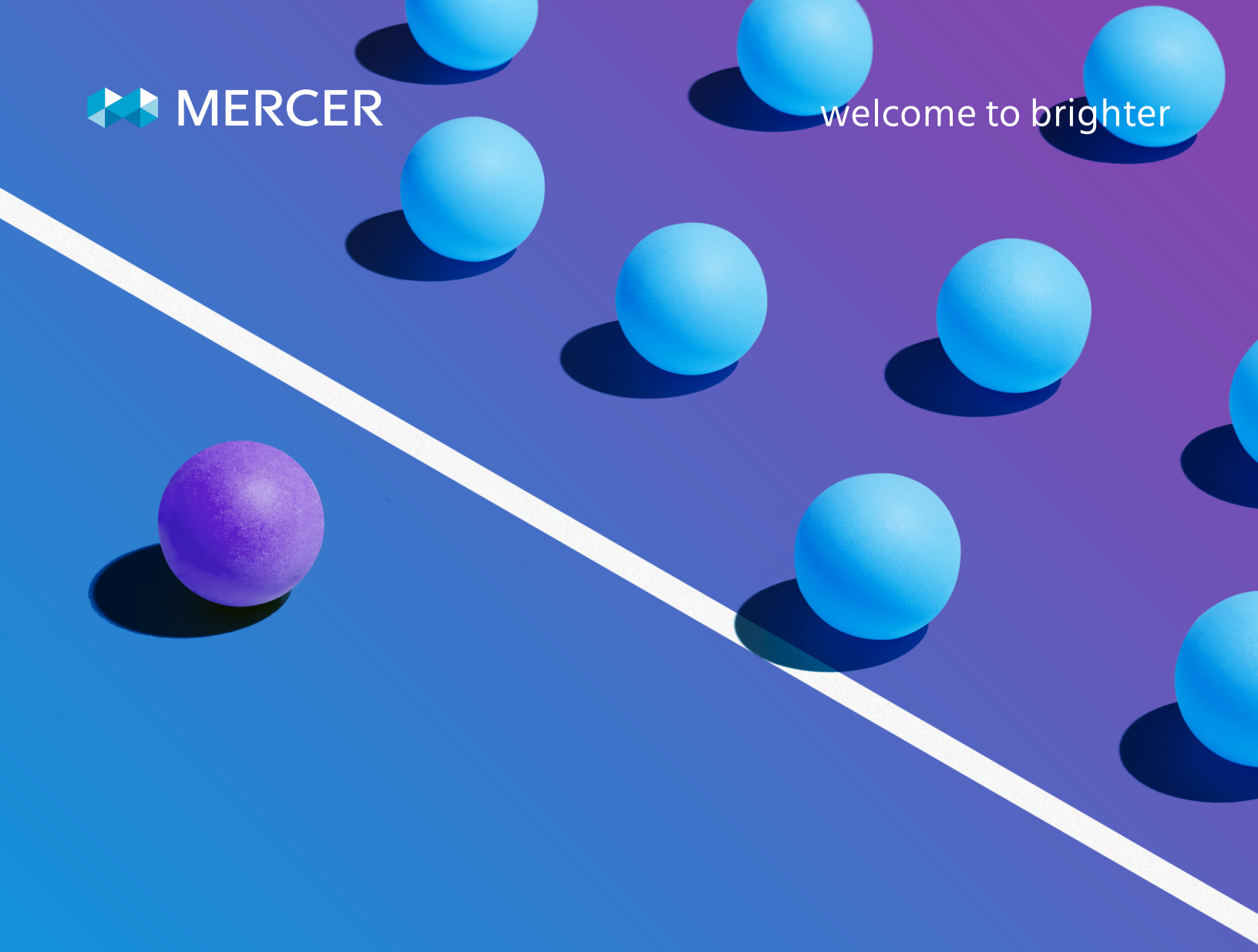
welcome to brighter



reinventing

retirement

Defined contribution plans

2021 priorities

An unprecedented year

2020 has shown us the critical importance of focusing on our people. The COVID-19 pandemic has impacted us all, but it also has affected some more than others. Understanding these impacts is critical to ensuring that benefit programs really address employees' needs.

Despite the unique environment, we have seen a notable increase in defined contribution (DC) plan[1] litigation. Bloomberg Law predicts that 2020 may see five times more class-action lawsuits targeting 401(k) plan fees than 2019.[2] A flurry of regulatory activity, prompted by the COVID pandemic, has also aimed to address issues like ESG investing, proxy voting and the fiduciary rules.

Plan sponsors must approach 2021 on two fronts — ensuring resiliency to address today's unique environment while evolving to prepare for a post-COVID world. In other words: Your plan and your participants must be ready for anything. In this environment, a participant-focused approach and flexibility are critical.

[1] For the sake of simplicity, a defined contribution plan would include any 401(k), 403(b) or 457 retirement plan.

[2] Wille J. "401(k) Fee Suits Flood Courts, Set for Fivefold Jump in 2020," Bloomberg Law, August 31, 2020.

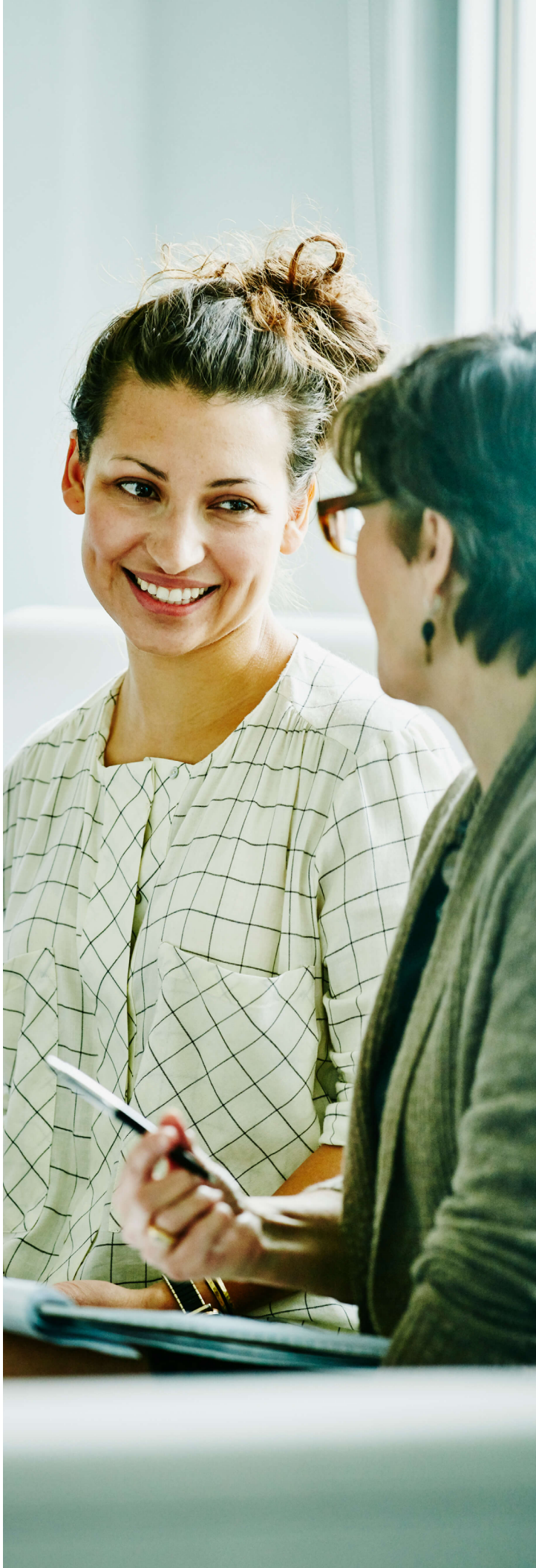
Here are six things you should consider as you set priorities for 2021.

1. Understand your participants and what they value

It's easy to make assumptions about what your employees believe is important, but your plan's real value is measured by its participants. You need to view your plan through the lens of their needs.

As a start, review participant demographics and key behaviors across all of your benefits. 2020 brought unique behavioral insights via CARES Act withdrawal and loan provisions; how your participants utilized these features provides insight into some of the external financial pressures your participants experienced. Use segmentation analysis to better represent and understand what different subsets of your population may value and need.

Diversity, equity and inclusion (DEI) is an issue of far greater focus today than just 12 months ago. It provides an opportunity to look at your DC plan in a different and instructive way. When used as a lens to view investment and distribution decisions, DEI can influence your plan design and communication strategy. Taking the time to consider trends in behavioral patterns can also help prevent unintended consequences from implementing changes that otherwise appear beneficial.



2. Design plans that can truly benefit your participants

Once you understand what your participants value, ensure that you design your plans with those "wants" in mind. Participants in DC plans typically are in one of two phases:

- **The accumulation phase**

  While plans traditionally have been focused on building retirement assets, the reality is that participants have a broader range of needs during this phase of their working life.

  One crucial learning from the COVID-19 pandemic is the impact of not having short-term resources available to address a financial crisis. While the access afforded by the CARES Act was beneficial, the reality is that DC plans are not the ideal way to handle unexpected or short-term financial needs. And those who used them for this purpose may find themselves even further from meeting their income needs when they ultimately retire.

  Employers responding to the Employee Benefits Research Institute (EBRI) 2020 Employer Financial Well-Being Survey indicated that the financial wellness benefit of most significant interest is emergency funds/emergency hardship assistance.[3] Some are already implementing emergency savings accounts or financial coaching.

  The future is likely to value a more flexible plan that better meets the diverse needs of the workforce — whether part time or full time. While employers will need to evaluate where their financial benefit dollar is best spent, they shouldn't overlook that there's still a long way to go to prepare their employees for retirement as they do so.

- **The retirement phase**

  It's generally accepted that retirees would benefit from the ability to retain their assets in the plan at retirement and to draw an income. A recent T. Rowe Price study found that 77% of baby boomers, 83% of generation Xers and 88% of millennials would keep their assets in their plan if provided a retirement income option.[4]

  Yet, participants unsure about investing during their accumulation phase are even less clear about managing their drawdown during retirement. Progressive sponsors looking to fill this gap should begin to introduce a retirement tier to their program.

The retirement tier is comprised of any product, solution, tool or service that simplifies or facilitates the decisions that need to be made by plan participants prior to, at and during retirement, taking into account their own household circumstances, in order to ultimately generate income.

Essentially, it is a lens through which participants view the features of the plan and assumes they are either:

- Approaching retirement
- At retirement
- In retirement

We recommend that clients:

1. Identify your plan's population of participants nearing, at or in retirement.
2. Review how your participants are using the plan and compare utilization against the organization's objectives and aspirations.
3. Identify the range of participant needs.
4. Get to know what retirement income solutions are available in the market, and determine what type of options align with your objectives.
5. Establish a timeframe and strategy to implement (both short and longer term) that considers the state of the market and other plan priorities.

[3] Copeland C. "2020 EBRI Financial Wellbeing Employer Survey: COVID-19 Driving Benefit Offerings and Potentially Forcing Tough Budget Decisions," EBRI (Employee Benefit Research Institute) Issue Brief, no. 515, October 22, 2020.

[4] T. Rowe Price. *Retirement Saving and Spending Study*, 2019.

3. Consider the opportunities for communication and education in an accelerated digital world

COVID-19 and the realities of working from home have resulted in an acceleration of digital living. One in three companies now anticipate that half or more of their employees will work remotely post-COVID.[5] More people have become adept at Zoom video calls, working paperless, using telemedicine and shopping online. Increased digital acumen creates opportunities for more frequent, targeted and cost-effective engagement strategies.

Regulatory activity is also advancing digital engagement within DC plans. The Department of Labor finalized electronic delivery regulations that allow for greater reliance on electronic delivery of required documents. And interim final rules have been issued for the SECURE Act's lifetime income disclosures. Once implemented, these rules are intended to present participants with a view of their retirement savings as a source of income, not just as a source of wealth. We have also seen increasing digitization within recordkeepers, including providing more digital advice. We expect this trend to accelerate.

Plan sponsors previously challenged in reaching participants may find new avenues because of these developments. For those engaging their recordkeepers to implement a digital communications strategy, there is an opportunity to monitor utilization and adapt to find the most successful messaging, timing and vehicles. For some, there may be an ability to deliver customization that was previously cost-prohibitive while still creating an opportunity for potential cost savings as production and distribution of printed materials decline.

[5] Mercer, 2020 Global COVID-19 surveys. Available at https://taap.mercer.com/covid19results.

4. Monitor recordkeeper consolidation and the accompanying digital evolution

It's not surprising that we have seen significant consolidation in the DC recordkeeping marketplace, given the dramatic fee compression at the same time that technology spend has escalated. There is also an ongoing focus on expanding adjacent revenue streams through supplemental services (like managed accounts) while reducing costs (through efforts like electronic delivery) to enhance profitability. Plan sponsors need to be diligent in overseeing their current providers and evaluating alternatives, especially given recent class-action settlements alleging recordkeepers' use of plan participant data for other purposes (for example, marketing other products).

Plan sponsor oversight needs to go into other areas as well. The underlying technology platforms used by recordkeepers are shifting to the cloud, and the use of bots to complete routine functions is expanding. While we anticipate long-term benefits from cloud-based recordkeeping, in the short run, there are challenges with the transition, particularly for highly customized plans. It's paramount to understand not just what your plan requires, but how your recordkeeper is delivering to meet those requirements.

In addition to seeking increased efficiencies, recordkeepers are also focusing on expanding their technology to respond to ever-present cybersecurity and fraud threats. The industry has worked collectively to try to manage cyber threats; however, differences exist in the ability to identify and respond, particularly to fraud attempts. Plan sponsors should evaluate their provider against industry best practices in advance of the forthcoming Department of Labor focus on cybersecurity, which is likely to impact on plan sponsors and recordkeepers' investigations.

In short, monitor your recordkeeper, but be sure to go further to understand their business model and technology strategy. Ensure that everything that can be done is being done to protect your participants from fraud and data breaches.

5. Consider whether expanded outsourcing options make sense for the plan sponsor and/or your participants

The strain the current environment is placing on plan sponsors is evident in recent Mercer surveys, which indicated that nearly 50% of respondents feel they are spending less time than they would like to on their retirement plans.[6] Coupled with the ongoing push to do more with fewer resources, the interest in outsourcing solutions, we believe, will continue to increase. In this context, "outsourcing" can be anything from the execution of plan sponsor administrative tasks and vendor oversight to outsourcing investment management responsibility. This is not a new development in this area: 3(38) delegation of investment management responsibility has grown significantly in recent years and this trend is likely to continue as Cerulli predicts "continued strong growth in the OCIO industry."[7]

In 2021, plan sponsors will see the emergence of pooled employer plans (PEPs) created by the Secure Act. PEPs will enable a plan sponsor to offload even more fiduciary and administrative responsibilities to a third party, the pooled plan provider (PPP). At the end of the day, the primary responsibility left to the plan sponsor will be to select and monitor the PPP. Similar arrangements already exist today as "groups of plans," but both PEPs and "groups of plans" will allow the application of the outsourcing concept more broadly. Beyond the sponsor benefits, some of these outsourcing options may offer advantages to plan participants through lower fees and access to higher-quality investment options.

Some plan sponsors will want to retain their existing roles and responsibilities for various reasons, while others will see advantages to outsourcing. There is no "one size fits all" solution. But plan on watching these programs as they develop and possibly reviewing the available options as well as their potential benefits for you and your participants in 2021.

[6] Two Mercer surveys of approximately 200 retirement professionals conducted in June 2020 and August 2020.

[7] PGIM. "The Evolving DC Landscape: The Expanding Role of OCIOs," October 14, 2020.

6. Reassess investment opportunities in an evolving market environment

2020 has been characterized as a year of "business as unusual" and has brought with it substantial market volatility and significant dispersion of returns earned. With this backdrop, consider opportunities to assess and strengthen your investment lineup:

- White label/multimanager investment options are an opportunity to potentially enhance outcomes for participants by streamlining investment choices and eliminating overlap while often improving diversification and smoothing returns. At the same time, fiduciaries benefit from reduced manager-specific risk and improved efficiencies.
- Alternatives were addressed by the Department of Labor in an information letter that can be used as a blueprint for the inclusion of alternatives in multi-asset class funds (predominantly target date funds) offered by DC plans. Alternatives are one way to potentially improve the risk-return profile for DC participants, and sponsors should ask their target date fund manager whether they will be looking to include alternatives in their strategy. For those sponsors currently using or considering a custom target date approach, consider whether an allocation to alternatives is appropriate from both an investment and operational perspective.
- Environmental, social and governance (ESG) investing was targeted in a proposed rule by the Department of Labor. The final rule no longer targets ESG but does highlight that investment decisions should be based on pecuniary factors. While Mercer believes that ESG factors can have a material impact on long-term risk and return and are pecuniary in many cases, this proposal increases the burden placed on ESG considerations. While digesting the final rule, plan sponsors will need to carefully consider (most likely with ERISA counsel help) how they wish to deal with ESG investments.
- With diversity, equity and inclusion (DEI) top of mind for many, consider understanding the DEI practices of your service providers, including investment managers. Proceed with caution, though — when making investment decisions or hiring service providers in an ERISA fiduciary capacity, the fiduciary must not subordinate the financial interest of the plan's participants and beneficiaries to non-financial goals or objectives.

Things to watch for:

(in addition to the next wave of the pandemic)

Legislative change. The Securing a Strong Retirement Act of 2020 (also known as SECURE 2.0) has already been proposed, which includes auto-enrollment for many new plans, PEPs and CITs for 403(b)s, a national online database of lost retirement accounts and much more. We do not believe this will be brought forward until 2021, but watch this space.

Continued litigation. The pace of litigation has been astounding, including the tackling of broader issues and litigation moving down market from mega plans to smaller DC plans.

Change:

- Electoral and administration change, which could result in a revision of recent regulatory activity and a new retirement policy agenda — creating further uncertainty as well as potential for market volatility.
- A new proxy voting rule (we have already seen a draft).
- Pooled employer plans' impact on the DC plan market.

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