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# Defined contribution: Who’s flying the plane?

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Imagine that, after a long stretch, vacation travel once again awaits. As you prepare for your trip, however, you notice that things are different than you remember. For instance, the airline calls you to directly offer additional services such as determining all your travel logistics, coordinating transfers and booking accommodations. After that, the pilot contacts you, offering to hand-select a flight crew on your behalf for an additional fee and promising an improved experience. While you are trying to evaluate these new options, the lead flight attendant sends you an email, informing you that she now has her pilot’s license and can both fly the plane and provide all the in-flight services needed to get to your destination efficiently, all at a lower cost than you’d ordinarily pay. This analogy describes the current landscape for retirement plans, where historically clear roles have now expanded, providing new, important decision points that plan sponsors will need to understand and evaluate.

Defined contribution (DC) plan governance[1] has traditionally been a linear progression of investment oversight and servicing as shown in Exhibit 1.

**Exhibit 1: A view of traditional DC plan governance**

Oversight →

| Plan sponsor | Investment committee | Consultant | Asset manager |
|---|---|---|---|
| The sponsor has several duties to the plan, including setting overall strategy and objectives. For those who view their plan as a vehicle to prepare employees for retirement, this will likely include setting the plan’s funding policy through optimization of automatic enrollment and escalation. | The investment committee will determine the appropriate structure for the plan, oversee performance on a regular basis and monitor plan service providers such as the investment consultant and asset managers. | Consultants provide strategic advice around issues such as plan design and investment structure and use their manager research expertise to recommend high conviction managers. They also ensure that managers adhere to their philosophies and execute in a way that is expected to add value for participants. | Asset managers implement the strategy they were hired to manage. |

← Services

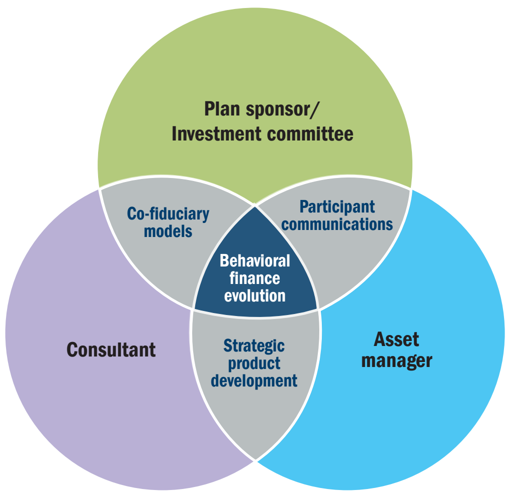
**All of these parties are fiduciaries and provide services to the plan, both through their oversight functions and support of investment, operational and regulatory needs, though in different capacities.**

Source: Russell Investments and Columbia Threadneedle Investments

This all appears to be straightforward, but many DC plans are evolving from this model given their growing prominence as primary retirement plans both domestically and globally. For instance, many DC committees are beginning to realize they would benefit by focusing their time on impactful strategic initiatives designed to improve participant outcomes, while outsourcing day-to-day investment decisions to either an internal subcommittee or an outsourced chief investment officer (OCIO). These alternate models are warranted since DC plans have not yet proven to be as successful as defined benefit (DB) plans in providing employees with a lifetime of sustainable income, potentially exacerbating retirement and workforce management challenges.

In direct response to this gap, many DC plans today are seeking to provide innovative solutions designed specifically to get participants from point A (entering the workforce) to point B (successful retirement[2]). To achieve this critical goal, particularly in a world where DB plans are less commonplace and Social Security benefits may be less generous, collaboration among the key players in DC has increased meaningfully. This has led to blurred lines across areas that historically were well-defined.

**Exhibit 2: Traditional DC areas are becoming increasingly shared**




Source: Russell Investments and Columbia Threadneedle Investments

We believe this evolution away from a linear model is genuinely positive, though it's worth spending a moment to review some of the trends and developments with these overlapping roles, including the potential benefits and additional considerations.

## Investment committee and consultant: co-fiduciary models

### The pilots are running the airline!

While the personnel running an airline are the best in-house experts on the airline overall, pilots have broad experience with the world's largest and most complex airports, and they can apply this expertise to ensure best practices and improve outcomes. Now let's consider an investment consultant as the pilot, offering OCIO services to a plan. Consultants with expertise in co-fiduciary models may take on direct responsibility in areas such as asset allocation,[3] manager selection, fee negotiations and operations. This model has been growing in popularity, and as of March 31, 2021, $2.46 trillion in worldwide assets were fully or partially delegated to a co-fiduciary.[4]

Efficiency is improved as the consultant leverages their research and strategic resources, negotiates directly with their highest conviction managers, and handles implementation and execution. Risk is also managed through the consultant taking on additional fiduciary responsibility. These benefits come with the additional task of careful OCIO selection, however, and ongoing monitoring of the OCIO. Plan sponsors should consider the processes and reporting they require to appropriately oversee their fiduciary partner.

## Consultant and asset manager: strategic product development

### Be creative and travel smarter

The difference between an average and a great flight experience is often determined by the quality of the flight attendants. Similarly, the difference between investing with skilled vs unskilled managers is substantial, particularly with actively managed strategies. Once again, the expertise of consultants can pay dividends here. They've worked with multiple investment committees and asset managers, informing their advice on how to evolve the industry and improve outcomes. For example, consultants are becoming directly involved in strategic product development with asset managers. Instead of accepting standard products that are in the marketplace, consultants are working with managers to build solutions aimed to deliver truly differentiated options for participants. Some examples of this include:

**Exhibit 3: Collaborations on product development**

**Multi-manager funds constructed with high conviction mandates**

Examples include asking managers of diversified products to construct concentrated versions of their strategies, with the consultant taking the role of combining several of these managers into portfolios with targeted risk and return characteristics. This aims to provide better diversification and higher expected outperformance at fees similar to typical diversified funds.

**Smart beta exposures**

Consultants have worked with managers to build implementable, low-cost portfolios isolating certain factors that historically were hard to separate from active security selection. This applies to both traditional asset classes (e.g., equity risk factors) as well as more diversified exposures (e.g., fallen angels, merger arbitrage).

**Environmental, social and governance (ESG) and responsible investment (RI) integration**

Consultants have helped bridge the gap between investor demand and manager processes with respect to ESG and RI. The industry is still in the early stages of determining best practices for RI, leading to increased manager receptiveness to consultant feedback given their exposure to clients, regulatory experts and asset management peers.

Source: Russell Investments and Columbia Threadneedle Investments

As with any strategy under consideration, investment committees must assess how these innovative options align with their investment beliefs and plan objectives. Benchmarking and peer comparisons may be challenging, leading to heightened monitoring needs to ensure efficacy of any unique exposures.

## Plan sponsor and asset manager: participant communications

### There's a reason the flight attendants are the ones giving the instructions

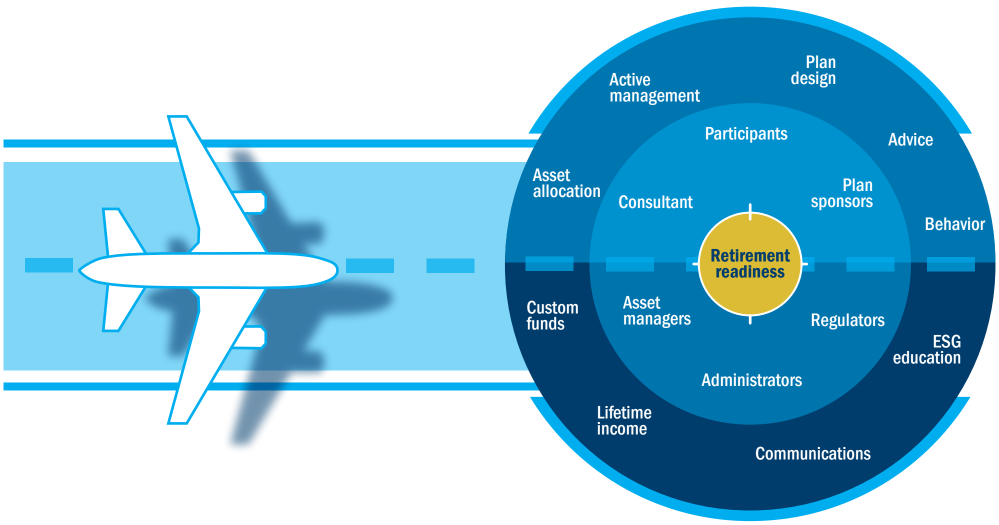
The earlier example of flight attendants offering to take on more responsibility recognizes the importance of their connection with passengers. For similar reasons, asset managers are taking a more active role in communicating to participants as a complement to education provided by plans' recordkeepers. The proliferation of target date funds as the plan default — target date assets stood at $3.27 trillion at the end of 2021[5] — encouraged managers to offer enhanced communication support when serving as the target date manager. This trend has increased concurrent with higher adoption of guidance and advice services, interest in retirement income solutions and improvements in recordkeeping technology. Asset managers may now provide written communications to participants, but many are also developing digital platforms to provide guidance and advice to participants, such as asset allocation tools and retirement income calculators. Of course, sponsors need to be aware of any communications to their participants to ensure they are appropriate and balanced.

# Plan sponsor, consultant and asset manager: behavioral finance evolution

## Who's flying the plane?

Ultimately, if the plane is taking us to a destination of retirement readiness, then the participants are the passengers. To improve that journey, the entire DC industry has supported advancements in behavioral finance and integrated them into DC decision-making to ensure that participants have the tools and structure needed to succeed, as illustrated in Exhibit 4. Plan sponsors use the status quo bias to improve outcomes via plan design enhancements such as auto-enrollment and auto-escalation. Asset managers increasingly leverage big data to ensure that products and solutions are built for purpose. Consultants use plan-specific data, including demographics, savings patterns and withdrawal behaviors, to ensure suitability of DC solutions, off-the-shelf and custom alike.

**Exhibit 4: To achieve retirement readiness for participants, there must be strong market collaboration**




Source: Russell Investments and Columbia Threadneedle Investments

The DC landscape is dynamic, and the list above is not exhaustive. Importantly, the changes discussed all occurred because of a recognition that DC plans need to transform to meet the growing needs of participants. As such, plan sponsors should review their current plan structures and committees should evaluate their governance to determine whether improvements can be made. Understanding the evolving offerings in the DC market can help plan sponsors ensure that their participants get to their destinations and can enjoy their long-planned journeys.

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[1] Focus is on parties involved in investment governance, though there are other key parties that focus primarily on non-investment areas including recordkeepers, trustees and custodians
[2] Part of the evolution is driven by increased focus on the definition of "success," with retirement income generation at the forefront
[3] Typically for white-labeled funds and custom target date funds, if appropriate
[4] Pensions & Investments
[5] Morningstar Target Date Landscape Report, 2022



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