The Colony Group

OPTIMIZING YOUR PLAN FOR PARTICIPANT SUCCESS

> Optimizing a retirement savings plan for participant success is one of the ultimate goals of any employer, but it requires thoughtful planning.

Plan sponsors often struggle to develop an investment plan that meets the diverse needs of their plan participants while fulfilling the requirements of their fiduciary duties. This white paper is a guide to optimize your retirement plan for participant success.

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OVERVIEW

Optimizing a retirement savings plan for participant success is one of the ultimate goals of any employer, but it requires thoughtful planning. For many participants, it is the only investment savings vehicle they will ever use and therefore it should be designed to be approachable and understandable. It should provide investment options and diversification without being over-complicated. It should weigh the overall costs with the potential investment opportunities. And, it should contemplate the needs and financial acumen of its participants and be communicated in such a way to make decisions easier for them.

Plan Sponsors are governed by a fiduciary standard which requires that they act prudently and make decisions for the sole interest of the participants and beneficiaries of the plan and for the exclusive purpose of providing benefits and paying plan expenses. However, the reality is that they are often in the difficult position of balancing their time and resources with the need of developing an investment program that serves a diverse participant population. We believe that by framing each decision with the end in mind—participants' retirement success—Plan Sponsors can design their plan to meet these objectives in a streamlined and efficient way.

ESTABLISHING THE INVESTMENT STRUCTURE

Establishing a sound investment structure is the foundation for participant success. Yet, many plan sponsors struggle to get it right. Here, we present the five key elements that will help plan sponsors design an investment plan that supports the needs of their participants:

1. Building Investor Personas
2. Creating Investment Options for Your Plan
3. Fee Transparency
4. Employee Education
5. Leveraging a Trusted Partner

Building Investor Personas

Creating Investment Options for Your Plan

Fee Transparency

Employee Education

Leveraging a Trusted Partner

BUILDING INVESTOR PERSONAS

To begin, we recommend building different personas to represent the plan participants within your retirement plan. This approach will help you to think about the needs of, say, the reluctant investor and the eager investor. Consider those who have the time and education to build their own portfolios versus those that are better served by an all-in-one approach. We like to think of these as "Doers vs. Delegators."

Each organization will be a bit different but establishing personas is a good starting point.

The Delegator Persona

Meet Jake. Jake is a customer service professional that's worked for his employer, ACME Paper company for 15 years. He's a dedicated employee who spends 45 hours a week at his job. He's also a family man, cheering on his two kids at basketball games and track meets on weekends. Jake's schedule doesn't leave him much time to do household chores, so he's hired a landscaping company recommended by his neighbor to mow the lawn every two weeks. He's been diligently saving away for retirement by following the guidance given to him when he joined the company to maximize his employer match. While he does open his 401(k) statements each month, he tends to look at the balance and promptly shreds his statements.

The Doer Persona

Meet Pam. Pam has worked her way up through the ranks at ACME Paper Company and is now the Chief Operating Officer. She puts in long hours but makes sure to carve out time to be at her daughter's softball games and dance recitals. She's also a voracious reader—getting up early each morning to read the Wall Street Journal. Each quarter, she carves out time from her busy work and home schedule to update her financial plan with her advisor. She goes to these meetings prepared—asking questions about specific investments, and is laser focused on ensuring that her savings rate and portfolio positioning are on target to achieve her retirement goals.

Creating Investment Options for Your Plan

CREATING INVESTMENT OPTIONS FOR YOUR PLAN

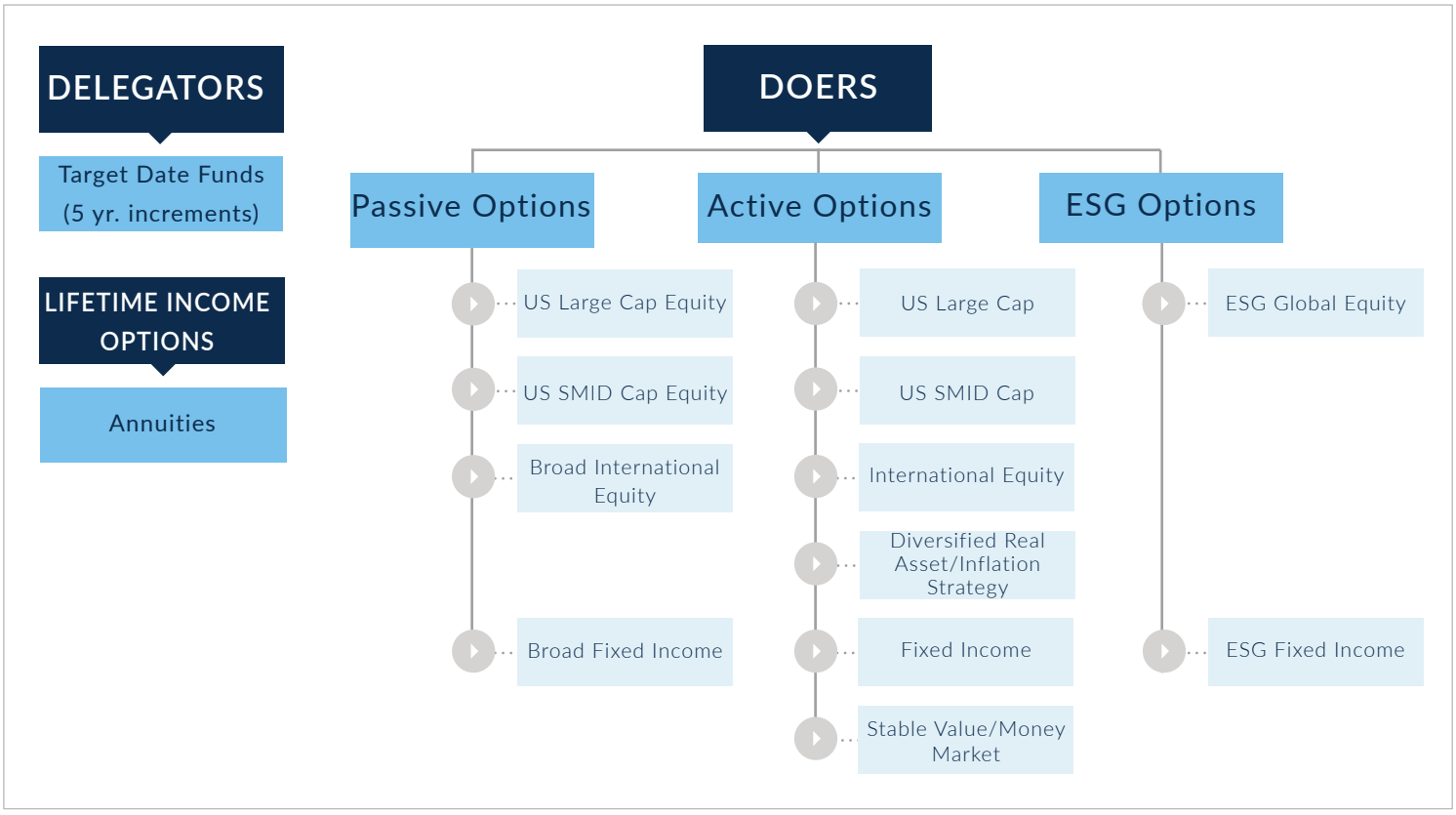
Now that you have developed your personas, it's time to select investment options that will best meet their needs.

For Delegators: A pre-packaged portfolio solution may be the best option for Delegators, like Jake. For most plan sponsors, this is either a Target Date or Target Risk Fund. Target Risk allows an investor to choose between a suite of portfolios—from more conservative to more aggressive and allocates to a number of underlying investments according to a generally static allocation. Target Date uses the anticipated date of retirement and gradually de-risks the portfolio as the date gets closer. While many plan sponsors struggle with the choice between Target Date and Target Risk, we think considering the persona can make the answer pretty clear. Target Date options align nicely with Delegators, like Jake, as they don't require that he actively adjust the risk of his portfolio as time goes on. While there's been criticism that a target date approach does not provide enough customization to the participant, that's actually the point. Doers are likely to choose another option.

For Doers: A diversified line-up of investment options may be the best solution for Doers, like Pam. She is eager to participate in determining the allocations within her portfolio and regularly dedicates the time necessary to keep up with it. So, how do we design an investment program that meets her needs?

We start by thinking about the investment options needed to build a diversified portfolio across major asset classes. At the highest level, we could offer just a broad equity market portfolio, a broad fixed income portfolio and a cash-like option (either Money Market or Stable Value). Similarly, we could expand the equities to include both an actively managed fund and a passive fund. We could also provide options which break out larger companies from smaller ones and US companies from international. In the extreme, we could conceivably offer 10, 20, even 50 options within just the equity portfolio. Even for Jane, that's likely too much choice.

While each retirement plan is unique and its investment menu will be different, we suggest that a starting point for the investment structure looks like this:



THE NUMBER OF OPTIONS

Some plan sponsors may believe that streamlining to just fourteen investment options is overly simplified to serve the needs of many participants, however, the data shows that as a plan grows, they are more likely to streamline versus expand their investment menus. According to the 2019 Plan Sponsor Defined Contribution Survey, the median number of options offered in a $5-$10 million plan is 23 while plans with over $1 billion is 16. Why? Large plan sponsors have been actively culling their investment menus for years. A 2003 study found that with every additional investment option offered to participants, plan participation actually decreased![1] A number of studies on human behavior has confirmed the finding: more choice can actually lead to less decision making. The advantages of a more streamlined menu, clearly communicated, means less funds to oversee and easier education for participants.

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ACTIVE VS. PASSIVE OPTIONS

Much debate has been had over the potential value of active management. On this topic, reasonable people can disagree. However, we think in the context of an employee savings plan designed to fit the needs of many different personas, offering both is sensible. For participants who prefer passive, we recommend providing an option that covers each of the major asset classes: US Large Cap, US Small-Mid Cap, International Equity and Fixed Income. For participants who prefer active management, we believe keeping options limited to the same asset classes as the passive tier gives enough optionality without overwhelming them with choice. In this example, we have also included a Diversified Real Assets strategy which is generally actively managed. Stable Value and money market strategies are, by their nature, active and are an essential component of a diversified investment program for participants who want to take minimal risk.

ESG OPTIONS

Many plan sponsors have sought to add strategies that incorporate Environmental, Social and Governance (ESG) criteria into the investment process. For some plan sponsors, this has been driven by participant demand. For others, it aligns with their overall mission and/or corporate sustainability programs. Importantly, offering these types of investments can further optimize the investment program for success. According to a study by Natixis 61% of participants said that if their plan offered ESG options, they would be more likely to contribute.

LIFETIME INCOME OPTIONS

Another investment to consider is a dedicated lifetime income option for retired participants who have entered the decumulation phase. The recently passed SECURE Act should make it easier for plan sponsors to offer this benefit. However, a number of products are likely to come onto the market in the coming years, and careful due diligence of providers is still necessary. Plan sponsors with aged workforces or a significant number of retirees should consider the options available.

Fee Transparency

FEE TRANSPARENCY

One area of potential improvement for many retirement plans is transparency around fees and expenses. This is also a hot button issue for many ERISA attorneys. Plan Sponsors have the responsibility to seek the most advantageous fees possible for the plan. While much attention is paid to the "headline" expenses of the investment options, it's important to remember that recordkeeping and administrative fees can have a significant impact on participant success, too.

Many plans use payments from fund companies (which are collected through higher expense ratios to the participants) to subsidize the recordkeeping and administrative fees. Others opt for lower investment expenses but instead charge a separate fee to the participant. Still other plan sponsors subsidize the cost of their plans directly from the firm's coffers. Each of these approaches has their benefits and drawbacks, but importantly, how the plan is paying its fees should be clear to the participant. This transparency is an important component of showing the plan sponsor's commitment to its fiduciary responsibility.

Employee Education

EMPLOYEE EDUCATION

Once a plan sponsor has developed their plan structure, determined the investment options, and made the fees as transparent as possible, the next step is to optimize participant success by educating the participants. Here, too, the personas are important. For **Doers**, this education includes the benefits of the active and passive tiers, information on the investment options offered, and expert advice from a trusted professional when they have questions. For **Delegators**, a more targeted approach that focuses on optimal savings rates, the proper use of the target date funds (for example, advising not to choose the 2020 fund because they had hoped to retire at age 35 this year!) and again, providing expert, unbiased advice as questions arise.

One often overlooked area of the employee education element is how investment options are presented. In one study, researchers determined that when an investment menu is presented alphabetically, participants allocate, on average, 10% more money to funds positioned in the first four menu items.[2] While there are certainly a lot of great investment options that begin with the letter "A"; there are also many that begin with "Z!" To counter this behavioral bias, we recommend communicating the structure similar to how the plan sponsor has designed it and intends for it to be used.

Leveraging a Trusted Partner

LEVERAGING A TRUSTED PARTNER

At The Colony Group, we understand the needs of plan sponsors and participants. Our institutional practice has been advising defined contribution and defined benefit plans for decades and has achieved certification with the Center for Fiduciary Excellence (CEFEX) since 2010[3], recognizing our commitment to sound fiduciary governance. A trusted partner in your employee savings plan can help you as the fiduciary to optimize the plan for your participants' success.

For more information, please contact us at 804-648-3500.

REFERENCES

[1] Huberman, G. & Iyengar, S.S. & Jiang, W. & Mitchell, Olivia & Utkus, Stephen. (2004). How much choice is too much: Determinants of individual contributions in 401k retirement plans. Pension Design and Structure: New Lessons from Behavioral Finance, Oxford University Press. 83-96.

[2] Doellman, T.W., Itzkowitz, J., Itzkowitz, J. and Sardarli, S.H. (2019), Alphabeticity Bias in 401(k) Investing. Financial Review, 54: 643-677. doi:10.1111/fire.12188

[3] The Colony Group's institutional practice primarily operates from its Richmond, VA office, which joined Colony in March 2015 when CapGroup Advisors merged with and into The Colony Group. CapGroup Advisors was certified by CEFEX each year from 2010-2014. As a part of Colony, the Richmond, VA institutional practice received the certification from 2015 through 2020.

DISCLOSURES

The Colony Group