Mid Year Refresh –

Is your defined contribution plan ready for 2020 and beyond?

as of July 2020

Defined contribution (DC) plans have evolved over time – from being supplementary retirement accounts to becoming the primary retirement savings vehicles for most U.S. employees. Along the way, DC plans further adapted into moderately accessible savings accounts (e.g., for large life events, such as purchasing a home, or to help pay down student loans). Today, we're witnessing the next evolution of DC plans, as the COVID-19 (coronavirus) crisis and new legislation have granted employees unprecedented access to their DC money. Employees are now able to turn to their DC plans for a variety of financial needs – from meeting traditional long-term retirement objectives and funding medium-term life event purchases to relieving dire short-term financial needs.

This evolution offers an opportunity for plan sponsors to reimagine the structure and management of their DC programs, driving more innovation and adaptability within investments and financial wellness as well as a sharper focus on compliance. This article suggests action steps in three broad areas – financial wellbeing, investments and plan compliance – to help DC plan sponsors address the challenges and opportunities of 2020 and beyond.

Financial wellbeing

1. Measure workforce stress and listen to your employees.

The effect of the pandemic on employees has been far-reaching, affecting their health, emotional wellbeing, work experiences and financial wellness. Even before the crisis, employees were financially struggling. According to Willis Towers Watson's 2019 Global Benefits Attitudes Survey, conducted pre-pandemic, nearly 40% of employees could not come up with $3,000 if an unexpected need arose. And now, not surprisingly, many employees are under severe financial stress. How to respond?

A first step is to size up the problem. Leading-edge employers are using sophisticated analytics to guide decisions and understand how financial vulnerabilities differ across the workforce. With the Coronavirus Aid, Relief, and Economic Security (CARES) Act, plan sponsors now have additional insights. For example, coronavirus-related distributions and loan repayment deferrals provide additional "signals" to help identify employee segments under financial stress.

WillisTowersWatson

But measuring financial stress isn't just about analytics. In times of crisis, employees want to be heard. Since the onset of the pandemic, we've found some of our highest participation rates in employee listening activities. People want to connect – especially those working from home or in isolation. Pulse surveys and new technologies such as virtual focus groups can provide deeper insight into employee pain points and solution preferences. At the same time, they demonstrate that leadership cares about employee wellbeing.

2. Provide employee decision support as we recover.

Responding to employee preferences need not be costly. In fact, in Willis Towers Watson's COVID-19 Benefits Survey, 67% of employers report that the number one benefit priority over the next six months is to communicate existing wellbeing programs.[1] For example, a hub or microsite focusing on benefits and resources already available can go a long way. Keep communications easy to find and navigate. Keep messages short and simple. Be genuine and show empathy.

Employees are facing complex and urgent decisions: Should I take a plan loan or a withdrawal? How and when should I pay back my CARES Act distribution? Can I suspend dependent care or commuter benefits to secure short-term funds? How do I renegotiate my debt? What relief is available from the government? In the past, employers provided concierge financial advice mainly to executives and primarily for retention purposes. But times have changed, and more employers are focusing on financially stressed populations. When evaluating financial wellness partners, plan sponsors should consider using the services of a vendor consultant who can provide guidance and knowledge of the fragmented and rapidly evolving marketplace.

3. Explore innovative design solutions.

Crises often spur innovation, and the current crisis is no different. One outcome may be innovative design ideas that finally address the problem of emergency savings. For example, employers can set up aftertax accounts or in-plan Roth sidecar accounts that employees can use to fund emergency savings up to a target threshold (e.g., three months of salary). Employees can then withdraw aftertax dollars to address financial emergencies instead of taking a loan or hardship withdrawal, both of which come with associated repayment requirements and/or unfavorable tax ramifications. This plan design takes advantage of the psychological tendency for employees to "bucket" money for different purposes.

Another example is unused vacation time. Among the over 800 employers who participated in our COVID-19 Benefits Survey, more than half plan to take actions to address the anticipated surplus of banked vacation hours at year's end. This presents a potential plan design opportunity: Allow employees to contribute unused paid time off to the DC plan in the form of a special elective non-matching contribution.

Employers will need to decide what they want their DC plans to look like post-crisis. What is the plan's purpose, and what design changes are needed? Some employers may decide that plan competitiveness is the primary goal and only modest changes are needed. Others may look to reimagine plan design to increase flexibility and create a better balance between short-term needs and long-term retirement readiness. This evolution will help employers to empower their people and best assist them in optimizing plan outcomes.

Investment trends

4. Make plan investments work harder *and smarter.*

We are reminded yet again of the need to manage volatility, as we saw equity prices (and government bond yields) plummet in February and March with a corresponding about-face, and run up in April and May followed by a volatile June. Our go-forward outlook contains three potential economic scenarios for emerging out of COVID-19, and all of them bake in elevated volatility for the foreseeable future. This message is more poignant through the lens of a DC plan, and more still for a DC plan's qualified default investment alternative (QDIA).

Looking under the hood of the QDIA is a key exercise in understanding the fund's risk posture, both for those just starting out and those closer to retirement. The asset mix in off-the-shelf target-date funds (TDFs) is dominated by publicly traded equities, investment-grade fixed income and short-term investments. Some TDF providers will target allocations to liquid diversifiers, such as real estate investment trusts, Treasury inflation-protected securities and commodities. Still, as exhibited by large asset owners, such as defined benefit plans, truly meaningful diversification and potentially superior participant outcomes can be found in alternative investments (e.g., direct real estate, private equity and hedge funds). Historically, DC plans haven't utilized these types of investments due to their illiquidity, pricing, fees and governance requirements; however, sponsors, consultants and investment managers can now judiciously add these asset classes to further diversify the current generation of TDFs while enhancing potential outcomes for participants. In fact, the Department of Labor (DOL) recently provided guidance to this effect, reducing fiduciary risk for plan sponsors embarking on this path.[2]

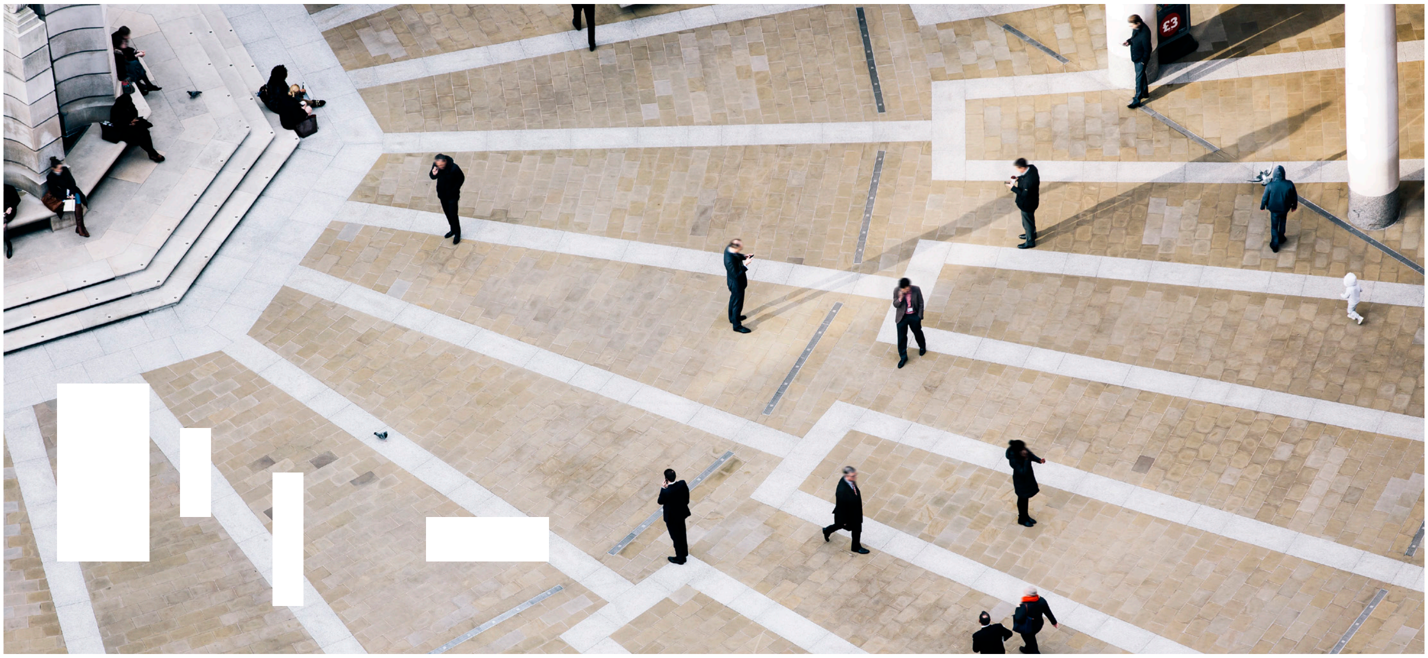
A detailed evaluation of including these asset classes in TDFs shows meaningfully improved outcomes for participants. In 2018, Georgetown University's Center for Retirement Initiatives, in conjunction with Willis Towers Watson, extensively studied the value of increased diversification in TDFs, finding it had the potential to increase the annual retirement income of DC participants by more than $9,000 without adding any complexity to the participant experience.[3] Equipped with a clarified fiduciary standard and the opportunity to provide better participant outcomes, we believe that now is the time for most plan sponsors to reevaluate their QDIA.

5. Align investment structure to be fit for purpose.

In the past, participants have needed to make several decisions regarding their DC plan: How much should I save? What should I invest in? Is this the right level of risk? DC plans have evolved to adapt to these needs, adding "nudges" such as auto-enrollment, auto-escalation and QDIAs to ease the decision-making process. Now, current conditions have woven new and crucial decision points into this process: In the era of the Setting Every Community Up for Retirement Enhancement (SECURE) Act, the CARES Act and COVID-19, participants are faced with several financial trade-offs as outlined above (see the Financial wellbeing section). Specifically, the need to balance short-term financial needs with long-term retirement goals has added urgency and complexity to a participant's decision-making process: Should I take a withdrawal following the birth of my child to cover some pressing expenses? Can I afford to take a coronavirus-related distribution? Can I afford not to? Should I take out a DC loan instead?

These new choices are also coming at a time when employee interaction, communication and attention have been interrupted or diminished due to COVID-19. Add a dash of heightened market volatility and participants are faced with a more complicated decision structure than many are equipped to handle.

Evaluating the DC investment framework in light of participants' new and drawn-out decision structure can help shed light on ways to ease this burden. We believe one method is to redesign the lineup with a streamlined set of multi-manager white label funds. Importantly, a key benefit of white label funds is maintaining a user-friendly structure along with the ability to build portfolios fit for purpose. For example, baking in diversification and constructing a portfolio to help maximize risk-adjusted returns is an efficient way to champion long-term results while protecting from short-term market dislocations. This approach is ideal for a DC plan that may be tapped more frequently than in the past as it acts as both a short-term emergency savings vehicle and a long-term retirement savings account. Lastly, by building the portfolios with complementary, high-conviction investment managers, this framework can potentially result in greater returns, lower risk and lower fees than traditional actively managed funds while still offering an easy-to-use DC plan structure at the participant level.



6. Harness new flexibility to empower your people toward a sustainable retirement.

We expect the adaptable and flexible work environment forced by COVID-19 to have a significant impact on the timing and method of retirement for many employees. Out of necessity, many employees across the U.S. have moved to a remote work or reduced hours structure. While leading experts don't expect the current remote work level to be permanent,[4] we do expect increased work flexibility to last well past the age of COVID-19. Looking at this through a retirement lens, we expect more employees to consider slower, smooth transitions into retirement, such as phased retirements or flexible, remote or part-time arrangements.

Outside of societal evolution, recent legislation has also focused on more flexibility for those approaching retirement. The SECURE Act and CARES Act have both provided more flexibility in terms of how and when participants can take money out the plan, providing greater choice and flexibility for participants. The SECURE Act in particular lessened the fiduciary burden on plan sponsors' implementation of some retirement income solutions.

We believe the need for plan sponsors to offer appropriate and flexible spend-down solutions for retirees is now more important than ever. We encourage plan sponsors to take a fresh look at the available retirement income solutions that can help participants balance income needs with growth potential, empowering those close to retirement and optimizing outcomes to – and through – a flexible retirement.

7. Reassess the most effective governance model.

Governance of DC plans grows more challenging each year, in a benefit environment expanding with new structures, such as emergency savings sidecars and health savings accounts, and increasing resources devoted to financial wellness. New legislation has also added to the already heavy load, specifically the SECURE Act and CARES Act, which have both become law in the past six months. Investment complexity is increasing as well, especially as the DOL has recently blessed the inclusion of more esoteric asset classes in QDIAs, as discussed above. Finally, the global pandemic has resulted in many companies shifting their focus from long-term strategy to more immediate needs. Given this environment and to ensure consistently high fiduciary standards, we believe sponsors should consider delegating responsibility for constructing and monitoring these more sophisticated solutions. We suggest delegating investment decisions to either internal staff with appropriate expertise or an outsourced chief investment officer (OCIO).

Utilizing an OCIO hands over investment selection and monitoring to a dedicated specialist, leveraging outside expertise to potentially drive better returns and enhance risk management as well as lower costs due to an OCIO provider's scale in the marketplace. Employing an OCIO also frees up plan sponsor resources for advancing participant outcomes and the strategic vision of the plan.

Plan Compliance

8. Manage risk by assessing operational compliance and vendor performance.

Plan sponsors have experienced significant change in the benefit plan landscape over the past few months, perhaps more than ever before. While many challenges remain, we believe that one of the primary issues plan sponsors need to address is plan compliance. Many plans have experienced material changes over a short period of time; even where this hasn't happened, plan sponsors have likely shifted their focus to other exigent business matters. Add to this the reality that recordkeepers have had to implement substantial changes across their client bases with extreme urgency while already grappling with implementing the SECURE Act provisions, and you have a situation ripe for operational missteps.

Plan sponsors can effectively manage their risk by taking a variety of steps to assess operational compliance and vendor performance. Conducting a limited scope operational review on the adoption of applicable CARES Act provisions will allow a plan sponsor to determine whether such provisions have been implemented and administered appropriately and help ensure that post-crisis administration is set up effectively. Additionally, a payroll/plan compensation review assessing the impact of furloughs or layoffs can ensure that potential inaccuracies do not become embedded, thus leading to significant operational issues in the future. We believe taking these steps now can pay large dividends later from a risk management perspective.

9. Manage cyber risk wherever the workplace is.

DC plans can be vulnerable to cyber attacks on several fronts. Whether it's a data privacy breach or a direct attack on participant accounts, the stakes are enormous for participants and plan sponsors alike. And those stakes have been raised significantly in the current environment.

Prior to the pandemic, experts estimated that 3.6% of American employees worked from home at least two to three days a week, defined as "full time" for statistical purposes.[4] That figure represents about five million people. As the country comes out of COVID-19, the same experts estimate that this percentage will skyrocket to as much as 30% by the end of 2021 – a 733% increase.[5] This shocking jump represents almost 42 million people, just under a third of the American workforce, who will be working full time from home all the time.[6]

The extent of this transformation cannot be overstated. It took 15 years – from 2005 to 2020 – for the number of full-time work-from-home employees to expand from three and a half million to five million people.[7] That's a growth rate of about 2.86%, year over year. By contrast, COVID-19 will explode the current number more than eightfold in just 18 months. In short, the pandemic will accelerate what had been a gradual but growing shift into a new normal, the likes of which we have never seen before.

Given the obligation of plan sponsors to manage the cyber risk relating to their plans, we strongly encourage sponsors to assess the third-party risk inherent in plan administration. This assessment should focus on a DC vendor's critical systems, remediation protocols, workforce training and overall financial commitment to cyber security. Sponsors should also look to outside experts who can help evaluate controls, identify security gaps, review contract language, assess insurance coverage and benchmark vendor capabilities against other providers. Like any other fiduciary obligation, reviews of cyber security should have a place on plan committee agendas and be thoroughly documented.

10. Revisit SECURE Act provisions as focus shifts from crisis management.

Although part of one of the most comprehensive pension legislation packages in decades, many of the SECURE Act provisions and the opportunities they provide to plan sponsors to enhance their plans have taken an understandable back seat as the COVID-19 pandemic has played out. As many employers come out of “crisis management” mode, they will have a unique opportunity to not only look back at how their plans fared during the pandemic but also look forward to effectively reimagine how their plans should be designed and operated post-pandemic.

The opportunities provided by the SECURE Act to make meaningful plan changes are numerous and varied. Employers can help their employees build for retirement by taking advantage of enhanced safe harbor auto-enrollment rules. They can increase flexibility regarding in-service account balance access by adding the child birth or adoption withdrawal opportunity and expand account decumulation options by leveraging new lifetime income rules. And employers can explore the possibility of joining an “open” multiple employer plan to reduce plan expenses and the governance burden associated with sponsoring a plan independently. We encourage plan sponsors to re-familiarize themselves with the particulars of the SECURE Act and proactively engage in determining how to best implement applicable provisions to optimize plan design and operations moving forward. In evaluating the SECURE Act opportunities through the lens of the reimagination processes described above, employers can take a holistic approach to develop the “DC plan of the future.”

Conclusion

The COVID-19 crisis has paved the way for the most recent, and perhaps most salient, transformation to DC plans in the larger series of changes we’ve witnessed over the past several months. Together, these changes create an opportunity to reimagine DC plans for the future. As discussed, employees are turning to their DC plans for student loan payments, home purchases, emergency spending, children’s college expenses and eventually a secure paycheck in retirement. Clearly, this is not your parents’ retirement plan. Employers now have an opportunity to reimagine their role in financial wellness, in both the short and long term, and how they add value as they compete for talent. While we’ve outlined several approaches to reimagining different facets of a DC program to meet the moment, we expect additional evolution in this space – and quickly. One such innovation includes reimagining the role of the employer itself; for example, instead of independently sponsoring a DC plan, plan sponsors may be better able to serve employees’ total financial needs by providing access to a pooled employer plan – one that may offer a complete DC plan platform for this new life cycle of financial needs.

Sources

[1] Willis Towers Watson COVID-19 Benefits Survey, May 2020, https://www.willistowerswatson.com/en-US/Insights/2020/05/2020-covid-19-benefits-survey.

[2] U.S. Department of Labor: Employee Benefits Security Administration, "Information Letter 06-03-2020," June 2020, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020

[3] Georgetown University McCourt School of Public Policy Center for Retirement Initiatives, "The Evolution of Target Date Funds: Using Alternatives to Improve Retirement Plan Outcomes," June 2018, https://cri.georgetown.edu/wp-content/uploads/2018/06/WTW71824_WHITE-PAPER_Georgetown-CRI-Target-Date_Jun-18_Final.vs2_626.pdf

[4] Kate Lister, "Work-At-Home After Covid-19 – Our Forecast," *Global Workplace Analytics,* accessed May 1, 2020, https://globalworkplaceanalytics.com/telecommuting-statistics.

[5] Kate Lister, "Work-At-Home After Covid-19 – Our Forecast," *Global Workplace Analytics,* accessed May 1, 2020, https://globalworkplaceanalytics.com/telecommuting-statistics.

[6] Erin Duffin, "Number of full-time employees in the United States from 1990 to 2019," *Statista*, Feb. 4, 2020, accessed May 1, 2020, https://www.statista.com/statistics/192356/number-of-full-time-employees-in-the-usa-since-1990/.

[7] FlexJobs and Global Workplace Analytics, *The 2017 State of Telecommuting in the U.S. Employee Workforce Report,* accessed May 2, 2020, https://www.flexjobs.com/2017-State-of-Telecommuting-US/.

About Willis Towers Watson

Willis Towers Watson (NASDAQ: WLTW) is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has 45,000 employees serving more than 140 countries and markets. We design and deliver solutions that manage risk, optimize benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. Our unique perspective allows us to see the critical intersections between talent, assets and ideas – the dynamic formula that drives business performance. Together, we unlock potential. Learn more at willistowerswatson.com.

willistowerswatson.com/social-media

WTW465788/07/2020

willistowerswatson.com

Willis Towers Watson