MAY 2021 | WWW.DCIIA.ORG

Defined Contribution Institutional Investment Association
RETIREMENT RESEARCH CENTER

Plan Sponsor Views on Adopting Dynamic QDIAs

Contributors

A special thank you to these plan sponsors for making this study possible:

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INTRODUCTION

The Defined Contribution Institutional Investment Association (DCIIA) Retirement Research Center completed a project in late 2020 focused on investments in defined contribution (DC) plans, specifically the plan sponsor's use of the dynamic or hybrid qualified default investment alternative (QDIA). The dynamic QDIA can be defined as an investment option that starts a participant off in one investment product or solution (e.g., a target date fund (TDF), managed account (MA) or target risk fund) and, upon reaching a certain threshold (e.g., account balance, age) automatically transitions the participant into a second, more retirement-focused product or solution (e.g., annuities, managed account, managed payout fund, etc.).

Typically, a dynamic QDIA is structured as a target date fund with a reallocation of participants' balances into a managed account at a transition age, usually around 50 years old. This structure is the focus of this paper's research.

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DEFINITIONS

A **managed account** (MA) is a customized discretionary portfolio managed for a DC plan participant and is generally, but not always, provided by an investment manager that has been selected by the plan to serve as a (3)(38) fiduciary. The value proposition for a managed account is that a personalized portfolio — based on a participant's demographic information, such as age, income, portfolio balance, and other personalization inputs — will provide an optimized outcome, after fees. This personalized data can be obtained from both the participant and the plan's recordkeeper. The funds utilized to construct a managed account portfolio are typically the same funds available to participants on the plan's core menu.

Target date funds (TDFs) are designed to provide an investment solution through a portfolio whose asset allocation mix becomes more conservative as the target date (usually retirement) approaches. Target date funds' asset allocation mix typically provides exposure to return-seeking assets, such as equities, in the early years of an investor's working career when risk capacity is higher, and becomes increasingly conservative as the investor approaches retirement, with relative exposures transitioning progressively toward fixed income.

Because of the growing popularity of the dynamic QDIA, more needs to be understood about plan sponsors' motivations for adopting the product and the factors leading to its addition to the plan's investment menu.

Empower Retirement recruited seven plan sponsors that had adopted the dynamic QDIA between January 2019 and April 2020, and organized interviews with them. This report details the outcomes of those interviews and we believe the findings are representative of the broader dynamic QDIA market. We hope to do additional research in the future with plan sponsors and dynamic QDIA providers, as this product continues to evolve.

The respondents were upper and mid-managers from small DC plans (up to $250 million). All respondents play a significant role in the design and administration of their DC plan and have influence over the plan design decision-making process.

The telephone interviews were conducted from September to October 2020. Respondents included plan sponsors and their advisors who were actively involved in the decision to implement the dynamic QDIA. What follows are our findings from this qualitative research.

DECISION-MAKING PROCESS

Plan sponsors interviewed were in the process of changing recordkeepers for their DC plan or were an existing client when they first learned about the dynamic QDIA. Findings from the survey showed that plan sponsors had not been proactively seeking out the dynamic QDIA, but was introduced to it by the recordkeeper with the support of the plan advisors.

Plan sponsors did not report any prior employee demand for this type of product. Rather, it was plan sponsors' perception that employees closer to retirement would benefit from the personalized advice component of the dynamic QDIA. Analyses by some plan sponsors showed that plan participants' investments were not on an age-appropriate glide path and plan sponsors therefore felt the additional resources offered through a dynamic QDIA would prevent participants from experiencing negative surprises as they neared retirement.

Prior to implementing the dynamic QDIA, plan sponsors had typically employed a TDF or risk-based balanced fund as the plan's QDIA. Plan sponsors ultimately perceived the dynamic QDIA as a way to provide increased assistance to plan participants related to retirement planning. The advice offered through the managed account component of the dynamic QDIA was viewed as conflict-free financial advice that could help participants achieve their retirement goals. It was also viewed as a way to keep plan participants' assets in the plan after retirement, since a participant can access advice at a lower cost in-plan than in the retail market. Overall, respondents' perception was that the dynamic QDIA provides an enhanced experience and added support for plan participants, helping to set them up for long-term success in retirement.

While the decision to adopt a dynamic QDIA is the responsibility of the plan's fiduciary committee, in practice it can be a collaborative process involving senior executives and HR, finance, and accounting staff.

WHY IMPLEMENT A DYNAMIC QDIA?

Plan sponsors adopted the dynamic QDIA primarily because, from a paternalistic point of view, it would provide participants the age-appropriate service and advice they needed to optimize their retirement outcomes. Participants' investment sophistication, or lack thereof, helped drive the plan sponsors' decision to adopt the dynamic QDIA.

In some cases, the specific demographics of the plan's participants, with a significant population reaching retirement in the next 10 to 15 years, drove adoption. Plan sponsors wanted to provide this extra layer of advice and other services that come with a dynamic QDIA to help those nearing retirement. Finally, the dynamic QDIA also helped plan participants understand they can leave their assets in the plan rather than turn to a financial advisor in the retail market, where they would likely end up paying higher advisory and investment management fees.

QUOTES

"Over the next 10 to 15 years, we will have a significant amount of our workforce retiring. And that made us feel like, 'How can we help our participants to get them set up in a better way than what we had in the past, a way that will improve their retirement security?'"

"It's important to have products that can help participants achieve their goals, whatever those goals may be, but also to step in and take care of them, help them make good decisions, especially if they're not investment savvy."

IMPLEMENTATION CONSIDERATIONS

We asked plan sponsors if they had any specific reservations about the dynamic QDIA concept. Their primary concerns were related to: the process of making changes to the plan, how the dynamic QDIA might be perceived by participants, and the challenges of effectively communicating its advantages to plan participants. Plan sponsors did not see any disadvantages or challenges related to fiduciary risk (long and short term) related to governance or cost.

To help alleviate participants' concerns, the plan sponsors reported that they focused on the following considerations:

Implementation Strategy

The plan sponsors that were interviewed elected to implement the dynamic QDIA in one of two ways:

- Full-plan reset: all participants are defaulted into the dynamic QDIA, either the TDF or managed account, based on age.
- QDIA reset: participants that were defaulted into the previously existing QDIA are mapped to the dynamic QDIA, either the TDF or managed account, based on age. Existing participants that actively elect their investments remain outside of the dynamic QDIA. Any new participant joining the plan after implementation will be defaulted to the dynamic QDIA.

All implementations were done with an opt-out feature, where all participants, regardless of implementation strategy, could move out of the dynamic QDIA and manage their own investments. This could be done via the website or by contacting the call center.

Transition Age Rationale

The age at which assets are diverted to the managed account, which is called the transition age, was set based on the plan advisor's recommendation. Plan sponsors also anchored their transition age to participants' median age or an age when they felt participants should be making long-term plans for retirement. Typically, the transition age was 50, in order to give participants enough time before retirement to make any changes needed to improve their retirement security. Some plans had union employees that had an earlier retirement age and therefore also had a lower transition age.

Participant Communications

Providing effective communication and education were the biggest challenges cited by plan sponsors. In general, most participants tend to join a plan, make their selections, and forget about them, so directing their attention to the new dynamic QDIA investment and the benefits it offered was a challenge. Plan sponsors had questions about the best methods for explaining the concept, how to avoid confusion, and how to help participants whose primary language was not English.

Ultimately, plan sponsors were proactive with their communications, anticipating that there would be a range of questions from participants. They communicated often and in various ways (e.g., mail, email, flyers, website, educational sessions, etc.) so participants would clearly understand that they were being defaulted into the program and would need to actively opt out if they were not interested. Also, communications were very clear regarding the additional fees participants would bear and the benefits they would receive when in the managed account portion of the dynamic QDIA. Communications also occurred before participants were automatically transitioned from the TDF to the managed account.

Overall, while plan sponsors were prepared for a multitude of questions from plan participants, they were pleasantly surprised to receive very few such questions or concerns. There were no negative recurring themes or trends that they could measure, which may be an indication that participants had a positive reaction and/or were not highly engaged.

"We tried to be proactive with the communication, just anticipating lots of confusion and questions, but the reality was that there were a handful (of questions) when it was going on, but much less than I thought there would be."

RESULTS

For all plan sponsors, the opt-out rate was very low. For those that tracked this statistic, roughly 75% or more of participants remained in the dynamic QDIA and were age-appropriately invested in the TDF or the managed account. In some cases, plan sponsors felt that low opt-out rates were the result of low participant engagement and/or a belief that the employer was doing what was right for them. Some plan sponsors interviewed planned to track other success metrics in the future, such as retention in the dynamic QDIA and engagement with MA advisors.

"Overall, it's been kind of quiet from a question perspective. There weren't really any themes or any trends that we could measure, which I think is a good indication that there was a positive reaction."

FINAL THOUGHTS

Respondents did not feel that there were any surprises during the adoption and implementation processes. Typically, they felt that things went the way they expected they would whenever there are major changes to the plan

"Try to reinforce the importance around communication and making it incredibly easy for the participants to really understand the benefits around the dynamic QDIA."

Plan sponsors reported that while they may consider themselves innovators, they intend to take measured steps and follow a thorough decision-making process before implementing any new plan feature. Some firms reported that they are typically not first adopters of a concept, but after conducting a deep analysis of an idea and determining it is the right thing to do for participants, they will offer something new, even if it is not yet widely adopted within the industry.

Dynamic QDIAs can help meet the demands of plan sponsors and advisors seeking new ways to help ensure that their participants attain adequate retirement savings. It is important for the industry to understand the motivation behind plan sponsors' decision to adopt a new product and what barriers may stand in the way of successful implementation. This knowledge can then be applied to future services and products that help to further the retirement security of America's workers.

ABOUT THE DCIIA RRC

DCIIA's Retirement Research Center conducts rigorous, industry-informed research that is grounded in a practical approach focused on actionable insights. We adhere to a disciplined research methodology, governance and validation process. Our goal is to serve the industry as a reliable, unbiased, and authoritative research resource supporting improved retirement security—be it through plan design, institutional practices, investment solutions, or behavioral interventions. To learn more, visit: **www.dciia.org/page/RRCHome**.

ABOUT DCIIA

Founded in 2010, the Defined Contribution Institutional Investment Association (DCIIA) is a non-profit association dedicated to enhancing the retirement security of America's workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA's diverse group of members include investment managers, consultants and advisors, law firms, record keepers, insurance companies, plan sponsors and other thought leaders who are collectively committed to the best interests of plan participants. For more information, visit: **www.dciia.org**.

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