

A Mission of Retirement Plan Investment Design: “One Small Step” for the Plan Sponsor, “One Giant Leap” for Plan Participants



Why Should Plan Sponsors Support a Mission of Investment Design?

Plan design auto features—automatic enrollment, automatic escalation, and even safe harbor match, to name a few—have been hot topics. But what about investment design? Investments fall into the plan’s strategy when optimizing the retirement plan, and a carefully constructed investment menu can help participants maximize their retirement income potential. Unlike auto features and the added expense that comes with them, investment design benefits participants with little or no incremental expense by the participants or the plan sponsor.

Mission Checklist: Behavioral Economics Create a Blueprint for Effective Investment Design

Behavioral economics point the way to successful investment design. Much has been written about the topic of participant behaviors, but one behavior in particular—choice overload—is important to understanding effective investment design. Shlomo Benartzi (2012) notes this phenomenon in his book *Save More Tomorrow*, “...there is a growing body of research in psychology and economics (from laboratory experiments and real-world observations) indicating that there is such a thing as too much choice. Specifically, people find it easier to make decisions when faced with a small menu of options than with many possible choices.” One of those studies by Iyengar,

Huberman and Jiang (2004) discovered a negative correlation between participation rates and the quantity of funds in a defined contribution plan. A crowded plan menu can negatively impact how participants allocate their retirement savings across investment options. Iyengar and Kamenica (2010) report that participants tend toward lower equity exposure and higher cash equivalent exposure as fund choices increase.

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Next Generation Thinking—Let Gamification Energize Participant Engagement



This is an excerpt of an article originally published by T. Rowe Price in the RPAG *IMPACT* Fall 2015 magazine.

Humans are game players. We're hardwired to compete, solve problems, and achieve goals. Enter gamification: the art and science of applying game design to engage and motivate employees. While it has had success with all demographics, it has proven especially effective with millennials, who have grown up with the Internet and online games (earning the label "digital natives"). In the last few years, gamification has entered the mainstream as a proven business strategy.



DC Implications: Gamifying retirement planning

Saving and investing for retirement is no game. However, some DC providers are leveraging gamification techniques to make a serious subject more approachable and actionable. It's all about engaging people in the process and helping them make educated choices about the future.

Traditional participant campaigns are being supplemented or replaced by interactive alternatives. It could be a mobile app or online feature that enables participants to visualize different scenarios for retirement success based on their saving and investing activity.

Numerous online calculators use gaming techniques—such as a retirement "number" or "score"—to motivate employees to save more, invest appropriately, and achieve higher levels of success. Once they are engaged, providers have a better opportunity to help educate and improve decision making.

Providers are incorporating peer comparison features to tap into participants' competitive fires. For example, companies may implement a contest that pits different locations or work teams against one another to see which group can increase its plan participation, deferral amounts, or knowledge of retirement investing best practices.

Over 70 percent of Forbes Global 2000 Companies surveyed planned to use gamification for marketing and customer retention.¹

Over 70 percent of organizations had at least one "gamified" application in 2014.²

Nike+ and Fitbit used gamified products to drive over five million players to beat their personal fitness goals every day of the year.³

¹Van Grove, Jennifer (July 28, 2011). "Gamification: How Competition is Reinventing Business, Marketing and Everyday Life"

²Gartner Group

³Gabe Zicherman, author of "The Gamification Revolution." (Nike and Fitbit are not affiliated with T. Rowe Price or RPAG.)

Should a Retirement Plan Implement a Fee Policy Statement?

For the client who may be concerned about fiduciary compliance, a fee policy statement may give comfort. Like all other fiduciary actions, the value of this statement is a function of how well it is written (not too loose nor too tight) and how consistently a plan sponsor actually describes/practices the process documented. So, a fee policy statement can potentially create problems in addition to mitigating them.

Having said this, assuming the plan is being managed prudently, by conducting a comprehensive live bid every three to four years (or sooner if circumstances warrant), along with an annual “second opinion” based on national normative data (as in our annual Fiduciary Plan Review), and the plan sponsor responds appropriately to the conclusions and maintains documentation, this should provide sufficient documentation to mitigate liability.

The recent attention to this issue is good in that, if interpreted properly, it will raise awareness. On the other hand, it also may create a bias for action which may not be beneficial.

A written fee policy is not required and may not be necessary. It is sufficient to state in the Investment Policy Statement (IPS) that the fiduciaries will take the necessary steps to ensure fees are reasonable. A detailed fee policy may set fiduciaries up for failure and limit their flexibility in determining how fees will be structured.

Plan fiduciaries should have a complete understanding of how much a plan is paying in total and to whom, and they should benchmark the plan periodically to ensure the fees are competitive. If the investments are sharing revenue, the fiduciaries should decide that this is appropriate and should understand who is receiving this revenue. All of this should be documented through reports and meeting minutes.

Specialty Asset Classes in a Retirement Plan Menu

Specialty asset classes are those which do not fall into the “core” group of asset classes. Core asset classes include: U.S. domestic equities, international, and fixed income. For the purpose of this commentary, specialty asset classes consist of the following: technology, health care, emerging markets, and real estate.

While specialty asset classes can provide value when constructing a fully diversified portfolio, their inclusion in a retirement plan as a stand-alone option is potentially problematic. The concern revolves around expanded fiduciary liability exposure created by potential unsophisticated participants utilizing specialty asset class investments inappropriately.

The classic scenario is where a participant nearing retirement learns of attractive returns a co-worker has obtained by investing in a specialty asset class (i.e. Technology in the late 1990's). Subsequently, the participant decides to invest a significant portion of his/her account balance in the same specialty fund in an attempt to achieve similar returns. Due to volatility inherent in this asset class, the investment experiences a significant loss over the next year and the participant becomes disgruntled and seeks reparation from the plan. The participant may contend that he/she did not receive appropriate education regarding the risks inherent in the investment. And fiduciaries may be liable for allowing an imprudent investment to be offered within their plan.

Note that many core asset class funds do have some exposure to specialty asset classes. International funds may have some emerging markets exposure. Core bond funds may have high yield exposure. Domestic equities may have health care, technology and real estate exposure. This may cause some participants who invest further in specific specialty funds to be unknowingly and inappropriately outweighed in specialty asset classes.

Other concerning issues also exist. In the event of underperformance of a fund (or provider), where fund removal and mapping becomes appropriate, some providers do not have multiple options within a specific specialty class. Where then should these assets be mapped to? There is no clear “fiduciary safe” answer. In addition, many specialty asset classes do not yet have substantial benchmarks to assist in monitoring, a fiduciary responsibility.

The inclusion of specialty asset classes in a retirement plan menu should be considered carefully and subsequently the decision for or against should be well documented in the retirement committee’s meeting minutes. Your plan consultant is happy to help you with this process.

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Mission Control: Countdown to a Successful Launch Toward Participants’ Retirement Goals

A focused investment menu is the “5...4...3...2...1...liftoff!” approach to investment portfolio design, constructing the plan’s investment lineup so that participants can effectively “launch” toward their retirement goals while maximizing their retirement income potential. This investment design approach is as simple as it sounds: five target date funds (TDFs) by vintage per glidepath, four U.S. equity funds, three index funds, two fixed income funds and one international fund. Fewer options means employing broader investment mandates, which reduce choice overload and help better identify skillful active managers, directly affecting participant ending account balances—a successful “landing” at retirement. When building or reviewing a plan menu, consider this simple approach to streamlining plan design, while still offering participants everything they need to launch a robust portfolio.

This is an excerpt of *A Mission of Retirement Plan Investment Design* that was originally published in RPAG’s *IMPACT* magazine. Please contact us at 877.360.2480 or support@rpag.com to obtain the full article.

COMMUNICATION CORNER: Making the Most of Your Retirement Plan

This month’s employee memo provides participants with a few helpful hints to help them reach their retirement goals.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ (fiduciarybriefcase.com).

Call or email your plan consultant if you have questions or need assistance.

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