



Next-Gen Plan Investment Menus

As the retirement plan landscape has evolved, so have the investment menu options offered to participants. The Pension Protection Act of 2006 (PPA) marked a turning point in this history, creating a path to plan sponsor safe harbor regarding automatic features and qualified default investment alternatives (QDIAs). After the passage of PPA, DC plan investment menus expanded exponentially. Now the industry is seeing a trend toward condensed lineups as plan sponsors learn to craft more thoughtful menus that still allow for customization with fewer investment vehicles. While the lineup of the past centered around participant choice, the lineup of the future will likely center around participant needs.

“The key pieces of any DC plan menu are the QDIA and the core lineup,” says [Peter Ruffel](#), a manager in CAPTRUST’s defined contribution practice. “The QDIA provides a prudent, diversified option for less engaged participants, and the core lineup lets more engaged employees cater to their own risk and time horizon needs.”

Section 404(c) of the Employee Retirement Income Security Act (ERISA) provides a safe harbor for fiduciaries related to participants’ investment actions. One of the requirements of 404(c) is to offer a broad range of investment options consisting of at least three diversified fund options. But the average plan typically offers much more than that.



According to the Plan Sponsor Council of America's (PSCA) [65th Annual Survey of Profit-Sharing and 401\(k\) Plans](#), the average 401(k) plan now offers 21 investment options. "This is down from the average of 25-30 funds we were seeing a decade ago," says Ruffel. By providing so many investment choices, sponsors were hoping to invite customization, yet many funds saw minimal uptake.

"There is no right or wrong number of investment options," says John Hays, a manager in CAPTRUST's defined contribution practice. "In fact, there are studies on both sides of the debate that seem to present conflicting results." Some say too many funds can create negative outcomes. Others say that, with additional options, participants will diversify more.

In other words, although there is a trend toward condensed menus, *fewer* does not necessarily mean *better*. "There are a lot of right ways to build a DC investment menu," says Ruffel. "What matters is that investment lineups are aligned with participant needs."

Thoughtful Responses

Designing the optimal investment menu to meet participant needs requires being both proactive and flexible. For example, market conditions or industry trends may influence sponsors to pursue reactive menu changes, like adding multiple bond portfolios to balance stock market declines.

"Sometimes, sponsors need to react quickly, but they also need to think through the potential inertia of reactive decisions to make sure they can effectively unwind things if unwinding becomes necessary," says Hays.

Ruffel points to the global financial crisis of 2008 and 2009. In the years following, many asset managers were touting low-volatility investment products that appealed to people's desire for security and stability. "In the wake of chaos, low volatility sounds comforting, but as the market improved, those investors missed out on a significant amount of growth," he says.

When evaluating reactive moves in response to market volatility, economic headwinds, or inflation, plan sponsors should consider whether each new investment will still be prudent and desirable as the market and economy evolve. Investment performance is likely to fluctuate but should meet a baseline of growth to continue earning its spot on the plan's investment menu.

Trend following is another area where sponsors would do well to balance reactivity with a long-term view. Benchmarking investment menus against industry standards is a recommended practice, but deciding which trends to follow—and which ones may not be a good fit—will depend on each sponsor's unique participant base. For example, a manufacturing company with 5,000 working-class employees will need to meet very different investor needs than a healthcare organization of 200 highly compensated surgeons.

"The question to ask is: 'Will this actually benefit my participants' accounts?'" says Hays. "The answer will depend on the organization's goals and objectives, employee demographics, and existing



participant usage data.”

It’s also important to remember that not all trends will be relevant for all organizations. “Benchmarking can’t tell you what to do,” says Ruffel. “It just helps you understand what other people are doing.” Most organizations want to be evolutionary over time—not revolutionary.”

However, some sponsors will need to break with industry trends to meet participant needs. In that case, Ruffel says, “Documenting the process you’ve used to make that decision can be just as important as the decision made.”

Another way to fine-tune investment menus is by analyzing participant behavior. “Usage data can be a good starting point when making decisions about paring things down or adding new options,” says Hays. “A low participant count or low asset total can be a strong indicator that an offering may not be meeting participant needs.” By tuning in to data, sponsors can make informed changes.

Pushing Ahead of the Pack

Proactive changes are equally important. Recently, Ruffel and Hays say they have witnessed an increase in conversations about retirement income solutions, a sustained interest in managed accounts, and detailed questions about the benefits of dynamic QDIAs, also called dual QDIAs.

Although sponsors are interested in learning more about decumulation strategies and through-retirement glidepaths for participants, Ruffel says that most plan sponsors are still early in their journeys toward providing total retirement income solutions. “Many sponsors are already offering target-date funds designed to manage assets through retirement, sometimes up to 30 years.” According to CAPTRUST data, 87 percent of 401(k) plan sponsors use target-date funds as part of their investment menus, and nearly 47 percent of total participant assets are allocated to these funds.

“Now, some sponsors are exploring evolved target-date strategies with a built-in retirement income feature or annuity option that can provide participants with a steady stream of income during retirement,” Ruffel says, but this is still a very small percentage of plans.

Although target-date funds are now an essential part of designing a DC menu, they are still a relatively recent development. “Before the PPA, it was a novel idea to use target-date funds in a retirement plan,” says Ruffel. “PSCA didn’t even start surveying plan sponsors on the use of these funds until 2012. That means there are almost certainly other aspects of menu design that we’re talking about today as proactive or future-focused but that, in 10 years, will be expected table stakes.” Managed accounts are one investment solution likely to make that list.



Ruffel and Hays anticipate an increase in managed accounts going forward. These are accounts owned by individual investors but managed by a professional investment manager that makes discretionary decisions on the investor's behalf. Now easier than ever for participants to use and access, managed accounts allow participants to have personalized portfolios built using their individual financial situation and goals. This can be especially useful as the participant approaches retirement.

"However, these accounts may not be right for everyone," says Hays. "For participants in their 20s and 30s, a target-date fund may be more appropriate. But for those who are 10 or 20 years from retirement, a managed account can be a helpful option to help them reach their personal retirement goals." Hays says one important piece to consider is cost relative to the value and services received.

Plan sponsors who want to combine the benefits of target-date funds with managed accounts may choose to explore a new generation of QDIAs: those that utilize target-date funds for younger participants, but transition to managed accounts as participants approach retirement.

These dynamic or dual QDIAs can automatically adjust participants' investment allocations based on factors beyond just age and market conditions. Instead, they look at salary, account balance, pension or other savings plans, savings rates, sponsor match, and more to provide a more tailored investment experience across the participant's lifespan. Typically, participants will be transitioned into a managed account at a specified age when additional factors outside of risk and retirement horizon can be impactful to a tailored asset allocation.

This means even disengaged participants can receive personalized advice to optimize their retirement savings. And the more engaged participants are, the more customized the portfolios can become by adding assets outside the retirement plan and specific investment goals and objectives.

The Investment Lineup of the Future

As part of their fiduciary responsibility, plan sponsors should revisit investment menus periodically. "Otherwise, it's easy to get stuck in the habit of scoring each underlying investment and its performance outcome only, without taking a 10,000-foot view of the lineup itself," says Ruffel.

When evaluating which investments to add or subtract, the following questions can be helpful:



- Which investment options have the lowest engagement, either by number of participants or by total assets? Where are new contributions going?
- Do any pieces of the menu overlap with each other?
- Is the menu overly focused on one asset class or investment area?
- Are there any gaps that an additional offering could help to fill?
- What are other plan sponsors doing?
- Is a self-directed brokerage account (SDBA) option available to participants? If so, what investment options are available to them through that service?

Although the investment menus of the future will vary by sponsor, it seems increasingly likely that their core purpose will be to home in on and provide for diverse participant needs. The next decade of this evolution will likely involve a rapid development of tools, services, and products that nudge participants in the right direction in terms of how they are saving, how much they are saving, and—when they are finished saving—how they can withdraw money from the plan.

As data-analysis and money-management technologies converge, plan sponsors will be able to make better reactive and proactive decisions, informed by both internal and external data. But they're also likely to be reminded that investment menus are only one piece of the puzzle.

"A big part of retiring well means feeling confident in your retirement savings," says Ruffel. "Sometimes, that's not about investments at all. It's about tools, resources, and education. The investment menu isn't everything. It's just one component."

Hays agrees. "A huge part of this has nothing to do with the plan lineup in and of itself. It has more to do with the participants' ability to understand the lineup, use it well, and feel confident in it, so that they don't make knee-jerk reactions every time the market declines or the economy contracts."

Adapting to meet participant needs goes far beyond the design of retirement plan menus. It's a shift in mindset that is likely to sweep across the broad swath of employee benefits, from financial wellness and advice programs, to health savings accounts and retirement plan design changes that can help employees pay for college and meet emergency needs.

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