STRATEGICINSIGHTS | CASESTUDY

The Future Is Now: How a Retirement Tier Moves Us from Inertia to Action

Planning for retirement income is re-emerging as a hot topic for plan sponsors as they seek to better serve the diverse needs of their participants. In this sit-down interview, *Pensions & Investments* spoke with Drew Carrington, head of institutional defined contribution at Franklin Templeton Investments, and Neil Lloyd, head of U.S. defined contribution and financial wellness research at Mercer, about a way forward in helping plan sponsors tackle this challenge. They discuss the liberating "aha" insight that results when plan sponsors quit searching for the one silver bullet and put a simple framework around offering more options and tools to participants approaching retirement.

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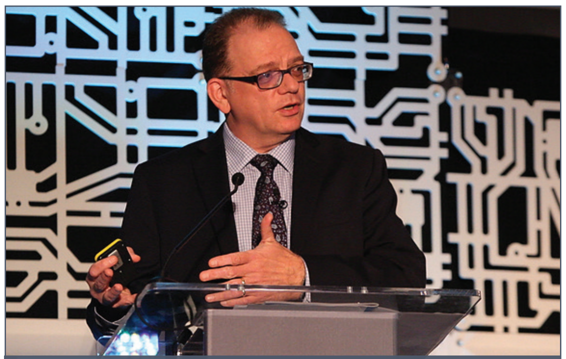

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PHOTOS: BARTOMEU AMENGUAL

| Q. | ***How are you seeing the conversation evolve in the DC industry around serving participants approaching retirement?***

| Drew Carrington | Retirement income is a topic that we have been talking about to plan sponsors, consultants, advisers and regulators for years. Things have come together to drive increasing awareness, even action.

Demographics certainly are one factor. We have had the cresting of the wave of baby boomers approaching and entering retirement. Another is the hot topic of financial wellness, which acknowledges that not all participants are the same, and this is an important point with respect to retirement income.

There is the realization that we aren't going to find a single one-size-fits-all solution for all the participants approaching retirement in a plan. Plan sponsors also recognize they need to address the unique needs of this population, who actually have most of the assets in the 401(k) system.

What we have discovered, and Neil is going to talk about this as well, is a new framework to think about this issue, which is offering a tool kit for participants approaching retirement — a Retirement Tier.

| Q. | ***Neil, would you agree? What kind of interest are you seeing from your plan sponsor clients?***

| Neil Lloyd | Over the last number of years, whether you attend meetings or conferences, there is a lot of talk but very little action.

Clients are aware that it is challenging to retire. You need to look for things that are not intimidating for plan sponsors to do, because they want to do the right thing but they don't want it to be too confusing, too complex, or expose them to litigation.

| Q. | ***What's unique about the population approaching retirement and what made you turn your attention to this group?***

| Carrington | As an industry, we have a generic view of participants as being disengaged, and that communication and education haven't really worked. Those assumptions are worth challenging broadly, but they are particularly worth challenging for the population over 50.

This population is much more likely to actively take control of the investments in their account. They are more likely to respond positively to personalized communications. They are more likely to go on the website and review their investments and savings choices.

And participants over age 50 actually have most of the money in the 401(k) system, somewhere between 60% and 65% of the total assets.

As we've discussed, this population is not homogenous, so it is much less likely we are going to find a one-size-fits-all solution. That is where this concept of a Retirement Tier really got launched.

| Lloyd | Retirement used to be a future issue. Now it's more of a current issue.

One point is that more and more retirees are remaining in plans and so plan sponsors are recognizing that their needs should be addressed.

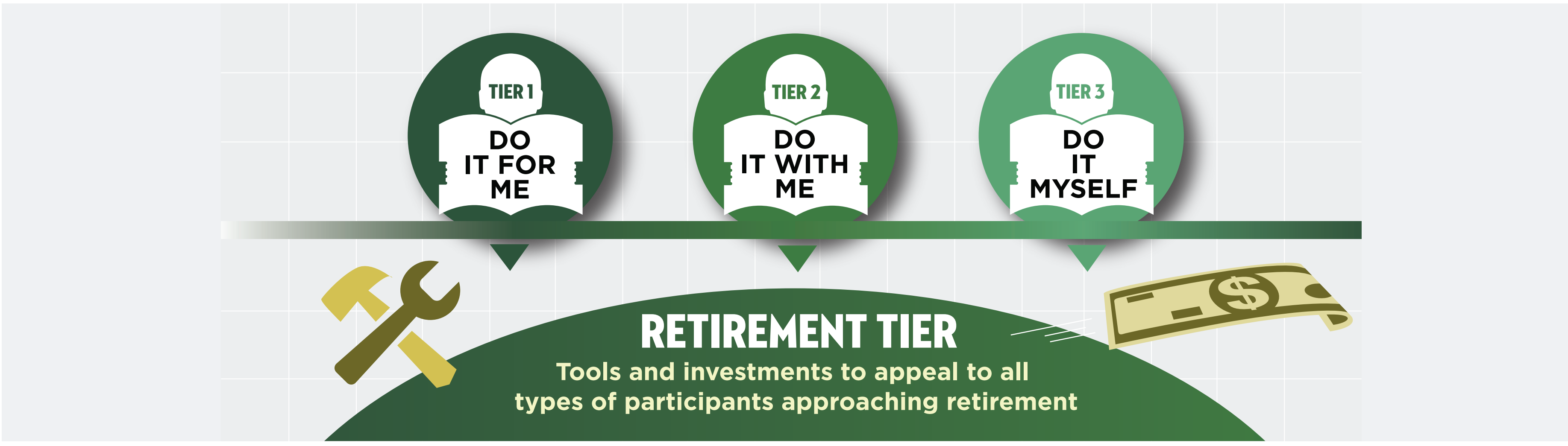
Also, we have found that as people get older, both in the U.S. and overseas, the use of the default option declines. Participants may be concluding that the default option is either too risky or not return-oriented enough for their unique situation. But at the same time, we found people get more engaged as they get older. So they need more options.

> "Retirement used to be a future issue. Now it's more of a current issue."
>
> Neil Lloyd, Mercer

| Q. | ***Tell us more about the Retirement Tier.***

| Carrington | We talk a lot about tiers in defined contribution plans: the do-it-for-me group, the do-it-with-me participants and the do-it-myself category. The latter may use a 'Tier 3' self-directed brokerage window.

We think about [the Retirement Tier] as composed of investments, tools, targeted communications and plan design



changes to make plans more accommodating to near-retirees and retirees. It is therefore more than just investment options but also tools like a Social Security optimizer that help participants prepare for retirement. If, for example, we can get participants to be thoughtful about when they claim Social Security, it can have a huge positive impact on their financial health — and their spouse's — in retirement.

| Lloyd | When we spoke to clients about retirement income, everybody was looking for the 'target-date fund for retirement income', the one-size-fits-all solution that they could click the box and it was done. But retirees are incredibly diverse. Some of them have other retirement assets, some have dependents, some have defined benefit pensions, some have health issues, some have a lot of debt, some have a house and some don't. The one-size-fits-all solution simply doesn't work.

We had discussions with a client looking at a default-type solution in terms of retirement income. It became clear that though this solution wasn't bad, it wasn't what you would want each individual to do. You need to think about more individual solutions that can address the diverse needs of individual retirees.

| Q. | ***What problem does the Retirement Tier solve?***

| Carrington | The biggest thing it solves is the challenge Neil alluded to. Plan sponsors were looking for this amazing solution that is going to solve everything for every one of your participants. We refer to it as a 'magic pink flying unicorn' solution — they are amazing creatures, but they don't exist.

The 'aha' moment for us was the realization that you don't have to solve everything all at once, and in fact, many plan sponsors are already making progress in this area. The Retirement Tier concept frees up plan sponsors to say, 'I don't have to find the perfect solution. I can start small, then build to offer a range of options and tools that will help participants all along the way.'

And that is a lot easier to do than pick the one thing.

The Retirement Tier enables action. We can move away from 'we are going to wait until we find the perfect solution' to 'we are going to act now.'

| Lloyd | We found when we started there were a lot of annuity or risk-sharing types of products out there and so clients were looking for these to be the ideal solution. But there are so many little issues with risk-sharing products that we typically saw clients get worn down and decide ultimately not to pursue those options: I often describe it as death by a thousand cuts. It might be a fiduciary concern. It may be product complexity. It might be, how do you explain it to members?

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>
> Drew Carrington, Franklin Templeton Investments

We have been trying to change the discussion and say, 'How can I take action?' Let's just focus on what we can do and try to make it better now, rather than waiting for the silver bullet or pink unicorn.

| Q. | ***What could make up a Retirement Tier?***

| Carrington | There's no one-size-fits-all Retirement Tier, just as there is no one-size-fits-all retirement income solution. In our view, a Retirement Tier would include a collection of changes to the plan.

These include plan design changes such as allowing for partial withdrawals. We are discovering that retirement is phased. It's chunkier than we thought and so enabling flexibility is important. Targeted communications and reaching out to participants who turn 50 and inviting them to take advantage of increased catch-up contribution limits can be really important. We would include specialized or targeted investments that solve particular problems for near-retirees.

And then finally, tools are extremely important. We alluded earlier to the concept of a Social Security optimizer, which is a great opportunity to help participants be more strategic about their Social Security claiming.

| Lloyd | Retirement-focused tools have improved materially. They can make a really big difference to financial security. We have been talking to clients more and more about retiree-focused investments. We advise looking at your investment lineup through the lens of retirees. Do they meet the specific needs of retirees?

| Q. | ***What barriers to progress do you see with your clients? What's the next step for plan sponsors to move from inertia to action?***

| Lloyd | The biggest barrier is the one mentioned in the question: inertia. Plan sponsors are going to ask us, 'Who else is doing this?' There is no doubt the more we see plan sponsors having a Retirement Tier and talking about it, the more take-up there will be.

My advice is, don't make this too complex. Don't envision the Retirement Tier as being 10 different things you need to do. Instead, learn what tools are being given to your retirees by your record keeper, managed account or advice provider. Look at your investments. Do they adequately address the needs of retirees?

And having done that, don't look for the perfect solution. There isn't going to be one. Look for small improvements you can make over time. It is a process. Build the Retirement Tier, but it doesn't have to have everything in one go.

Clients are pleased at what they have done — we could do a better job of celebrating their successes. There are more than we may be acknowledging.

| Carrington | The barrier has been this notion that it is a really big, complicated, difficult problem. 'I can't solve it all at once so I am not going to do anything.'

In reality, many plans already have some of these pieces in place. Whether it's a Social Security optimizer, or investments oriented to retirees, or targeted communications, these generally don't raise new issues with plan sponsors and committees.

To Neil's point, the success story isn't, here is a plan sponsor who has done everything. We can have successes that are steps along the path.

We don't have to solve it all. We just have to help get people in a position to retire more comfortably with more security. We can do that. We can do that today. ■

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