EXPERTS SEE MORE ROOM FOR STABLE VALUE IN DC PLAN INNOVATION

FALL FORUM 2021: SHAPING THE NEW NORMAL

By: Randy Myers

The defined contribution retirement plan market has seen some notable innovations over the past decade and a half. Automatic enrollment of participants and automatic escalation of participant contributions have boosted plan participation and savings rates. The advent of qualified default investment alternatives (QDIAs) has led to the mushrooming popularity of target-date funds, making it easier for plan participants to benefit from broadly diversified portfolios aligned with their investment horizon. But plan evolution is not over, according to a trio of experts who spoke at the SVIA's 2021 Fall Forum in October. They see opportunity for the retirement industry to find new ways to help retirees convert a lifetime of savings into a steady stream of income in retirement.

The panel was moderated by Aruna Hobbs, head of institutional investments at MassMutual Investments. She was joined by Glenn Jensen, founding principal with New England Retirement Consultants, and Christopher M. O'Neill, managing director, chief investment officer and director of quantitative research at Mesirow Fiduciary Solutions.

O'Neill pointed to the growing use of customizable default investment options as a significant trend that promises to continue. Customization allows a plan sponsor to better align plan investment options with the characteristics of their workforce and individual plan participants. Popular custom options include managed account programs and custom target-date funds. The latter are typically constructed using collective investment trusts (CITs) as the underlying investment vehicles. That presents an opportunity for the stable value industry, especially since most off-the-shelf target-date funds invest only in mutual funds. Federal regulations do not allow for stable value mutual funds.

In fact, O'Neill said, custom CIT-based funds and managed accounts that can serve as QDIAs present a real opportunity for any investment manager operating in the defined contribution investment only (DCIO) space. "That's really the name of the game—how do you get a slice of the qualified default (investment alternative)," he observed. "Because whether it's custom or off-the-shelf, that's where the vast majority of the asset flows are going."

Jensen, who worked in the stable value industry before starting his own firm in 2006, agreed that stable value should play a bigger role in target-date funds. An allocation to stable value could be especially helpful for target-date investors in or approaching retirement who can find it difficult to manage their portfolios through steep stock market downturns without jeopardizing their retirement security. With their principal protection guarantees, stable value funds could serve as the conservative anchor of a target-date fund.

While target-date funds are designed to meet an investor's needs into and through retirement, Jensen noted that most plan participants take their money out of their workplace plan within three years of retiring, suggesting that there is a disconnect between what target-date providers are trying to accomplish and the way many participants actually use the funds. Adding a stable value component to target-date funds, he and O'Neill suggested, could help protect investors' returns in down markets. And that could help dissuade investors from making rash decisions that can further erode their retirement nest eggs, such as selling at market lows.

Jensen acknowledged that the current low interest-rate environment may be depressing demand for stable value funds, which invest primarily in intermediate-term investment-grade bonds and suggested that use of stable value could go up when rates start to rise. Some economists and money managers believe rates are headed at least higher based on a recent uptick in inflation, since the Federal Reserve often steers rates higher to keep inflation under control. The Fed has already broadcast its intention to begin tapering its easy-monetary program of buying Treasury bonds and mortgage-backed securities, which would remove one of the supports that has been helping to keep rates low.

"We're in an exciting time," O'Neill said. "There is likely to be a normalization of the fixed-income markets that we have not seen really since the great financial crisis (of 2008)."

Asked by Hobbs what will have the biggest impact on the DC plan landscape in the near future, Jensen cited his expectations for more custom target-date funds and robo-advice services. He also expects that more plans will begin to offer annuities that provide guaranteed lifetime income or other products designed to provide reliable income streams for retirees.

O'Neill observed that plans and plan providers may push to have more plan participants keep assets in their plans even after retiring. "To some extent, this trend toward personalization and customization in qualified default investment alternatives is an effort to keep assets in the plan and help manage those assets near and through retirement," he said.

For stable value providers interested in driving more use of their products, O'Neill suggested pursuing co-manufacturing opportunities with other companies in their industry, with an eye toward integrating stable value more deeply into the products of those companies. "There is an appetite out there for the protection that stable value can offer," he stressed.